[H.A.S.C. No. 108–32]

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Y 4.AR 5/2 A:
2003-2004/32

The Report of the U.S.-China Ec

THE REPORT OF THE U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

HEARING

BEFORE THE

COMMITTEE ON ARMED SERVICES
HOUSE OF REPRESENTATIVES
ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

HEARING HELD
JUNE 16, 2004

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THE REPORT OF THE U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ARMED SERVICES,
Washington, DC, Wednesday, June 16, 2004.

The committee met, pursuant to call, at 2:04 p.m., in room 2118, Rayburn House Office Building, Hon. Duncan Hunter (chairman of the committee) presiding.

OPENING STATEMENT OF HON. DUNCAN HUNTER, A REPRESENTATIVE FROM CALIFORNIA, CHAIRMAN, COMMITTEE ON ARMED SERVICES

The CHAIRMAN. The committee will come to order.

This afternoon the committee is pleased to take testimony from the United States-China Economic and Security Review Commission, which was established by Congress to provide an in-depth and independent review of the many critical issues facing the relationship between the United States and the People's Republic of China.

Our witnesses are Mr. Roger W. Robinson, Jr., chairman, United States-China Economic and Security Review Commission; and Ms. Carolyn Bartholomew, Commissioner, United States-China Economic and Security Review Commission.

We welcome both of you. Thank you for taking your time to be with us and talk to us about this very important issue.

I thought we were doing, to some degree, all Iraq all the time. We have also been working our bill, moving our defense bill through the committee and through the House, but we are also trying to pay some attention to other important parts of the world, which to some degree are very interrelated.

We just did a hearing on Korea. We, just this morning, did a hearing on this very critical area of military control in post-transition Iraq, and it seemed appropriate to start to do some work on China. China is such an important player, obviously, with respect to the Korean issues, is also now a recipient of vast amounts of American cash and an emerging defense power in its own right.

And yet China does not often come up on the agenda. As you may know, there are not a lot of hearings about China.

And we see a few blusters about the trade deficit now and again, but outside of that, for a country with its impact on world events, it has not been enjoying a lot of scrutiny by this body, so I think it is very timely that we talk about it, especially with respect to security.

The purpose of the permanent commission is to monitor, investigate and submit to Congress an annual report on the national security implications of the trade and economic relationship between

the United States and the People's Republic of China. The commission is also charged with providing recommendations to Congress for legislative and administrative action.

It is important to note that this congressionally mandated commission was designed to be and is completely bipartisan. There are 12 commissioners, evenly selected by the House and Senate leaderships, both majority and minority. The chairmanship, now held by Mr. Robinson, alternates between Democrat-and Republican-appointed commissioners every year.

Another important feature of the commission is its broad scope. The commissioners assessed U.S.-China economic and security issues together, not separately. I think that is a very strong point. This comprehensive approach is important because it underscores the interrelationship between trade and security. Trade can help advance U.S. security interests, but it can also endanger them if it proliferates dangerous technology or undermines our strategic independence.

Yesterday, the commission released its 2004 report. Its findings, unanimously supported by the commissioners, are a wake-up call for U.S. policymakers concerned with both trade and national security issues.

The commission found that, "A number of the current trends in U.S.-China relations have negative implications for our long-term economic and national security interests and, therefore, that U.S. policies in these areas are in need of urgent attention and course corrections."

Some of the trade and security issues the commission studied include: China's military modernization efforts and the effect on the cross-Strait military balance, and that is a very critical issue for this committee. We have done some closed briefings that have touched on that, and some issue forums that have explored that area.

Its high-technology development and U.S.-China science and technology cooperation, is another important area, as is Beijing's proliferation practices, especially its role in the North Korean nuclear crisis. Additionally, of great importance is China's use of forced technology transfers in trade negotiations, the idea that if you want to sell them something, you have go to sell them the wherewithal for production and the trade technology.

Thankfully, the commission reminds us, the United States-China relationship is still in the relatively early stages of its development. So there is still time for the Congress to work with the President and U.S. industry to correct outdated or misinformed U.S. economic and security policies.

Chairman Robinson, Ms. Bartholomew, we look forward to your testimony and to the ensuing discussion.

But before we do that, let me just recognize my partner on this committee, the committee's ranking Democrat, the gentleman from Missouri, Mr. Skelton, for any remarks he would like to make.

[The prepared statement of Mr. Hunter can be found in the Appendix on page 51.]

STATEMENT OF HON. IKE SKELTON, A REPRESENTATIVE FROM MISSOURI, RANKING MEMBER, COMMITTEE ON ARMED SERVICES

Mr. SKELTON. Mr. Chairman, thank you.

I join in welcoming Chairman Robinson and Ms. Bartholomew, and I congratulate the commission on issuing a unanimous report. So, thank you for coming and testifying.

This is a very, very important subject. And because of the spotlight that is on the Middle East, I think a lot of folks do not see the importance in the area to which you have become experts.

Now, back in April, our chairman held an issue forum with the former Speaker, Newt Gingrich, as well as the former Assistant Secretary of Defense, Frank Kramer.

And what came out of that session, for me, is particularly, quoting Newt Gingrich, who seemed to understand the entire area quite well, was that the Taiwan Straits is among the most potentially dangerous places in the world, and leaves me with an abundance of caution about our policies there.

As the committee well knows, over 150,000 of our troops are already engaged in operations throughout the Central Command in Iraq and Afghanistan. Some of those forces have begun to be pulled from the Pacific Command and notably from Korea.

Our hearings from the last two days, and now this hearing today, show collectively the need for strategic thinking about the future challenges facing the United States, particularly in the Asian area. The commission, before us today, has identified a number of those changes in our multifaceted relationship with China. There are also opportunities in the near term to effect real change, and I look forward to your testimony to help us understand the challenges as well as the dynamics there. Thank you again for being with us.

[The prepared statement of Mr. Skelton can be found in the Appendix on page 56.]

The CHAIRMAN. I thank the gentleman.

And Mr. Robinson, Mr. Chairman, thank you for being with us. The floor is yours, sir.

STATEMENT OF ROGER W. ROBINSON, JR., CHAIRMAN, UNITED STATES-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

Mr. ROBINSON. Distinguished members of the committee, on behalf of the U.S.-China Economic and Security Review Commission, it is my pleasure to brief you on the commission's 2004 report to Congress, a report that I am especially proud to note received the unanimous approval of our bipartisan commission.

The commission has compiled a report that presents an assessment of the challenges and downside risks the United States faces in its relations with China. In addition to our analysis, we provide nearly 40 recommendations to Congress for addressing these challenges and risks.

Congress gave us the overarching mission of evaluating on an annual basis, "the national security implications of the bilateral trade and economic relationship between the United States and the People's Republic of China."

In answering this question, our research has led us to conclude something that the Chairman noted in his opening remarks. I am quoting from our report: "A number of the current trends in U.S.-China relations have negative implications for our long-term economic and national security interests and, therefore, that U.S. policies in these areas are in need of urgent attention and course corrections."

We also believe that the U.S. influence and vital long-term interests in Asia are being challenged by China's robust regional economic engagement, diplomacy and military buildup.

Beginning first with U.S.-China trade and investment, the U.S.-China economic relationship is heavily imbalanced and undermining our long-term economic health, at least at the present time.

The U.S. trade deficit with China reached $124 billion in 2003, with Chinese imports into the United States outpassing U.S. exports to China by more than 5 to 1.

While the sheer size of this deficit alone should be of concern, it is the various underlying causes that demonstrate the problem.

China has artificially suppressed the value of its currency by as much as 40 percent and continues to heavily subsidize its manufacturing sector in the form of tax incentives, preferential access to credit and capital from state-owned financial institutions, subsidized utilities and other measures.

Last, China's adherence to the market access commitments, it made as part of its World Trade Organization (WTO) agreement, has been, at best, mixed, with many U.S. producers continuing to face steep hurdles.

Our report makes specific policy recommendations to Congress concerning how to redress the imbalances in our trade relationship, something we feel obviously is urgent, given the erosion of our own manufacturing base.

The second major area is regional and cross-Strait developments. China is in the midst of a diplomatic offensive in Asia to reassure its neighbors of its long-term peaceful intentions. These efforts are buying time and space for China to pursue its economic development and increasingly offensive military buildup.

But it is the recent developments in China's relations with Hong Kong and Taiwan that are of particular concern. In Hong Kong, China has shown, very recently, a troubling aversion to the development of democracy there and to its commitments to preserve Hong Kong's autonomy under the so-called "one country, two systems" formula.

With regard to Taiwan, China continues to build up its offensive military capabilities targeted at the island, including a missile force of over 500, and to make clear its intention to use force to forestall what it views as Taiwan's movements toward independence. At the same time, it is undertaking a campaign to politically and economically isolate Taiwan in the region.

Next is military and technology advancements, the pace of China's development as a platform for high-technology manufacturing and research and development (R&D), fueled by foreign investment and technical cooperation, has exceeded many outside observers' expectations.

The extent to which these advances allow China to challenge U.S. competitiveness and technology development is a vital matter for U.S. economic security. The extent to which China uses its enhanced technology capabilities to accelerate its military modernization programs is of direct national security concern to the United States.

Within the context of these broad areas of focus, I would like to draw your attention to two specific areas of our examination that are of particular significance to the work of the committee.

First, arguably the most important test of the U.S.-China relationship in the coming months, and probably beyond, will unfold on the Korean Peninsula. It will involve China's willingness or unwillingness to use its extensive economic and political leverage to persuade Pyongyang to dismantle, irreversibly and verifiably, its nuclear weapons and ballistic missile programs in the near term.

Time is decidedly not on our side in this crisis. We believe China must step up to this crucial task more vigorously and quickly.

Second, we have examined China's military modernization programs in-depth and are greatly concerned about their pace of development. We held a hearing in February on this topic and commissioned an outside study regarding China's acquisitions of foreign military technologies as contributors to this program. Both highlighted the qualitative advancements China's military has made through infusions of foreign military technology and weapons systems primarily from Russia.

Our report concludes that, "China's quantitative and qualitative military advancements have resulted in a dramatic shift in the cross-Strait military balance toward China, with serious implications for Taiwan, for the United States and for cross-Strait relations."

The commission formulated a number of recommendations concerning appropriate responses by the United States to these challenges, and I would be pleased to discuss those following my testimony.

We hope the work of our commission will prove helpful to the committee and can serve as a resource for your ongoing deliberations on U.S.-China matters.

Thank you, Mr. Chairman, and I look forward to any questions. And I will turn it over to my colleague.

[The joint prepared statement of Mr. Robinson and Ms. Barthalomew can be found in the Appendix on page 61.]

The CHAIRMAN. Thank you, Mr. Robinson. And, Ms. Bartholomew, thank you also for being with us.

STATEMENT OF CAROLYN BARTHOLOMEW, COMMISSIONER, UNITED STATES-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

Ms. BARTHOLOMEW. Thank you very much. Mr. Chairman, Ranking Member Skelton and members of the committee, thank you for the opportunity to testify today. Thank you also for your leadership and your work in this important committee at a time of great challenges for our nation.

I am pleased to join Commission Chairman Roger Robinson in presenting the commission's annual report. That our report for this

year is unanimous and bipartisan is no small feat, given the political climate and the broad range of backgrounds, interests and constituencies the commissioners represent.

The CHAIRMAN. And on that point, Ms. Bartholomew, I understand that you have a joint statement for the record. We will, without objection, accept that into the record.

Ms. BARTHOLOMEW. Thank you. I credit my chairman for the achievement of a bipartisan and unanimous report and commend him for his leadership.

As you are aware, Congress is the commission's main client. I hope that you and your staff will consider us a resource in your deliberations relating to U.S.-China relations throughout the course of the year.

Listening to the memorial service for President Reagan on Friday, I was struck by the words of Baroness Thatcher, who said, "I cannot imagine how any diplomat or any dramatist could improve on President Reagan's words to Mikhail Gorbachev at the Geneva Summit: 'Let me tell you why it is we distrust you.'"

This sentiment describes today the commission's annual report, which provides ample documentation of why we continue to distrust the government of the People's Republic of China: The Chinese government's pattern of promises made and promises broken on trade issues, the proliferation of weapons of mass destruction (WMD) technology, and on human rights and basic freedoms continues.

This pattern has serious consequences for the United States. Among the commission's findings, on economic security: China is not adhering sufficiently to its WTO trade commitments; market access is still a problem for U.S. goods and services; and rampant piracy of intellectual property rights continues.

As my chairman mentioned, the U.S.-China trade relationship continues to be heavily imbalanced, with a skyrocketing trade deficit of $124 billion in 2003. China continues to be heavily dependent on the U.S. market, with 35 percent of its exports coming to the U.S. At the same time, only four percent of U.S. exports go to China. The deficit has grown at over 20 percent per year since 1990 and continues to grow at that rate in 2004.

All of these factors and others, including China's poor labor practices, are contributing to the erosion of U.S. manufacturing base and the loss of U.S. jobs.

On national security, despite claims that China is helping to halt the proliferation of weapons of mass destruction and related technology, numerous examples of such proliferation from China continue.

Serious allegations have also been made that North Korea is using Chinese facilities as trans-shipment points for North Korean WMD exports to third countries.

Despite claims that the Chinese government is helping with the North Korea crisis and, indeed, some credit is due for their assistance in getting North Korea's participation in the six-party talks, serious questions exist about why China is not exerting its considerable leverage on North Korea.

China is channeling its economic strength into rising political influence and military power in Asia at a time when Asian countries

perceive that the U.S. is focused on challenges elsewhere in the world. Just today, *The Wall Street Journal* reports on the growing concern of countries in the region about China's growing influence.

China is also ratcheting-up its military modernization programs aimed at Taiwan, and frictions are growing between China and both Taiwan and Hong Kong.

One of the commission's most far-reaching recommendations calls for a fresh assessment of U.S. cross-Strait policy, its successes, its failures and its continued viability.

This year the commission also focused on a new set of issues with broad implications for the United States.

On energy security, China has moved past Japan to rank second behind the United States in global energy consumption. It is the world's second largest oil consumer and its third largest oil importer.

China's rising energy demands has put added pressure on global petroleum supplies and prices. The recent escalation in gasoline prices here at home has been attributed, in part, to the impact of China's growing pressure on world oil.

Energy needs have also driven China closer to the Middle East and Africa, as well as neighbors in Central Asia, Russia and the Pacific. China seeks to lock-in secure energy supplies, especially new sources of gas and oil not subject to potential disruption in a time of conflict. It also seeks to control the resources at the wellhead or the source, bypassing world market mechanisms.

China has sought energy cooperation with countries of concern to the United States, including Iran and Sudan, which are inaccessible by U.S. firms. Some analysts have voiced concerns that China may have offered weapons-of-mass-destruction-related transfers as a component of some of these energy deals.

The commission report discusses in greater depth a number of other troubling aspects of the current U.S.-China relationship and their consequences.

Baroness Thatcher closed the comment cited earlier by saying some of President Reagan's words, "Those words are candid and tough, and they cannot have been easy to hear. But they are also a clear invitation to a new beginning and a new relationship that would be rooted in trust."

We, as a commission, believe in the importance of a sound and strong U.S.-China relationship, which benefits both nations and is rooted in trust.

To get to that point, however, we believe that a number of changes should be made to current U.S.-China policy. And we have developed almost 40 recommendations for your consideration, which are contained in the report.

Thank you again for the opportunity to testify. I look forward to your questions.

The CHAIRMAN. Ms. Bartholomew, thank you very much.

Mr. Robinson, thank you for your statement.

Let me just ask one brief question, and we will move to our other members.

The balance on each side of the Straits has been not, at least by my own estimation and I am certainly not an expert on it, but one in which Taiwan has the ability to readily defend themselves in

past years against a potential invasion. Where do you put that balance right now, and where do you put it in ten years?

Mr. ROBINSON. Well, Mr. Chairman, I think we share many of your committee members' concerns, that there is now a serious and even perilous imbalance in military capabilities in the cross-Strait relationship.

Most notable, of course, is the scale of China's offensive military buildup, targeting Taiwan facilities, some 500-plus at the present time, and adding some 75 missiles a year to that total.

Taiwan, for a host of reasons, budgetary and otherwise, has been moving at a slower pace than might have been expected, in terms of their own military modernization and procurement programs, as best we can tell. And I know that there has been an enhanced dialogue with Taiwan about hopefully stepping up the pace of those procurements. And I understand, in fact, that rather soon, a Taiwan delegation is due in the United States on that issue.

But we certainly think that right now the preponderance of force is clearly on the Chinese side. There has been an impressive, robust, largely offensive military buildup underway.

You know that some 17 percent of Chinese gross domestic product (GDP) or more is dedicated to military spending. They are purchasing frontline Russian systems, primarily Russian systems, from Sovremenny destroyers to Club-missile-equipped submarines.

And they are clearly not only preparing for the eventuality of a forceful unification scenario, so to speak, but also and even more disturbingly, the interdiction of U.S. forces that might seek to intervene to ameliorate that situation and avoid conflict.

I think the most disturbing aspect of this, and I am speaking personally on this point, is the potential for miscalculation. I mean, when you buy supersonic cruise missiles that can attack a carrier battle group, are you seriously thinking that that is a viable option?

There are 5,000 Americans, men and women, serving on a carrier, something of that order, and you can just imagine if such a missile was let fly, the potential consequences were for it to hit its target. I mean, this is something that would be both a national catastrophe and crisis.

So the very fact that that is deemed to be in the realm of possibility, in a cross-Strait conflict scenario, is very troubling to myself and, I believe, my fellow commissioners.

And so we spent a significant amount of time in our second annual report to the Congress on these matters, and so much so, that we feel that a fresh assessment of the one-China policy is indicated.

And by this we do not mean any kind of wholesale change in order, or trying to negate a strategy that has worked for us in preserving the peace these 25 years, but rather looking within the one-China policy as it exists today and determining, are we providing sufficient defense-related assistance to Taiwan at the pace needed to keep up with the Chinese buildup? Are we helping Taiwan adequately break out of economic and political isolation that Beijing has been very strenuously trying to enforce against it? Are we active enough in facilitating cross-Strait dialogue to avoid miscalculation and conflict?

We question whether we are sufficiently vigorous in these areas, and we will look to the committee's guidance as well as how those issues might be remedied.

The CHAIRMAN. Okay.

Ms. BARTHOLOMEW. Mr. Chairman, thank you.

Just a few comments to add to my chairman.

One, it is my understanding that the government of Taiwan recently published a report indicating that in five years the balance will shift to China's favor.

Clearly the military buildup in China is of serious concern. In Fujian province, there are 500 missiles aimed at Taiwan. They are being added to at the rate of 75 a year.

One of the issues that our chairman mentioned, was us calling for a fresh assessment of the current cross-Strait policy.

We believe that, of course, in the period of the 25 years since the one-China policy was implemented, what was called the status quo has changed significantly on the ground, and what might have been status quo then is no longer status quo. And we believe we really need to be taking a look.

It is entirely possible that the one-China policy will continue to be effective, but we believe that it is time for Congress and the administration to look at this and determine if it is going to continue to work or if it is making things more dangerous for us.

I would also, in terms of military issues, point out that one of our recommendations—because we want Congress to have more of an active role on these issues vis-á-vis the administration or working with the administration—so we note that the commission recommends that Congress enhance its oversight role in the implementation of the Taiwan Relations Act (TRA).

Executive-branch officials should be invited to consult on intentions and report on actions taken to implement the Taiwan Relations Act through the regular committee hearing process of the Congress, thereby allowing for appropriate public debate on these important matters.

This should also include, at minimum, an annual report on Taiwan's request for any military equipment and technology and a review of U.S.-Taiwan policy in light of the growing importance of this issue in U.S.-China relations.

Mr. ROBINSON. Mr. Chairman, if I could just correct a small matter that I think I misspoke on. The 17 percent was an increase in China's military spending from the previous year as opposed to the GDP figure. I am sorry for that.

The CHAIRMAN. Thank you very much.

The gentleman from Missouri.

Mr. SKELTON. Thank you both for your testimony. I will leave Hong Kong and Taiwan to others.

Ms. Bartholomew, I will ask you to open your history book. Go back to the 1920's and 1930's, early 1940's. And I understand there is always a difference in capability and intention. I want you to compare what Japan was going through in the 1920's and the 1930's and the early 1940's, prior to Pearl Harbor on December 7, 1941, as best you can compare similarities, and as best you can explain the differences.

You have five minutes in which to answer that question. [Laughter.]

Ms. BARTHOLOMEW. Mr. Skelton, I am certainly not an historian and do not have the historical expertise that you do. Honestly, when people ask the question, Japan vis-á-vis China, to me, they usually ask about the economic consequences of the buildup of Japan's economy in the 1970's and 1980's and is what China is doing now any different than what Japan was doing.

I can speak to the concern about the nature of China's government, which I think is one of the reasons that we are so concerned about these trends; which is China, of course now, is trying to build up socialism with Chinese characters. And of course what it is trying to do is allow economic growth to a level where it can sustain itself in power.

And I think the concern, of course, is, especially for those of us who have worked hard for democratic freedoms, that this is going to be unsustainable, and the kinds of freedoms that we believe the Chinese people should be experiencing are just not being offered to them.

I think there are a number of questions about the issue of hegemony, frankly. Is it that the Chinese government has aspirations beyond China in the region? I do not think we know the answer to that question yet.

I think there are serious concerns within the Asian region about what China's plans and intentions are vis-á-vis the other countries in the region. And I think that is something we also have to pay attention to.

One of the issues that Mr. Hunter raised in his opening remarks was a question about the U.S. role and are we paying enough attention.

Several of us traveled in Asia—we were actually, as you know, in Taiwan for the elections—but we were in Japan and we were in Hong Kong. And it was quite clear, everywhere we went, that people were very concerned that the United States is so focused on other challenges and so focused elsewhere that we have abdicated our responsibilities in the region. And that is making countries there quite uncomfortable.

That is the best I can do. I am afraid I cannot answer your question directly, in terms of Japan in the 1920's, 1930's and 1940's compared to China.

Mr. SKELTON. Thank you.

Mr. WELDON [presiding.] I thank the gentleman.

Before we proceed, Chairman Hunter had to take a very important phone call. His son, who is currently on active duty in Iraq, has just called him. So I know you all will bear with us as the Chairman goes out to the anteroom to talk to his son who is serving our country as a Marine in Iraq at this time.

We will have five votes, and we will break in about 10 minutes, so members will be advised there will be a 15-minute vote followed by four five-minute votes.

Let me thank you both for appearing today and tell you this is a topic that is something that I feel very strongly about.

Mr. ABERCROMBIE. Excuse me, Mr. Chairman, before we go on. As you said, we have four votes, a 15-minute vote, four five-minute

votes. The 15-minute vote is going to be 20 or longer. It may cause some real difficulties in members coming back.

I hate to say this, but this is such an important hearing, I suggest that we might have to schedule this again. Please, I do not mean to interfere, Mr. Chairman, but I have an idea that we are going to be gone the better part of an hour.

Mr. WELDON. Are you both going to be able to come back?

Ms. BARTHOLOMEW. Mr. Abercrombie, Mr. Weldon, we actually both came up with the expectation that you were going to have to leave to vote, and we can stay around for several hours if members can come back.

And, of course, we are available individually to answer any questions or have any discussions that you might want to.

Mr. WELDON. Thank you. And we will come back. And I thank the gentleman for his comments. We will come back, because the topic is such a timely one for this committee.

Let me just say that John Spratt and I served on the Cox Committee, which was a nine-member panel that looked at the issue of China's access to our technology in the 1990's. And we took a 9–0 vote that our security was, in fact, harmed.

But following that effort, in looking in detail at what happened, I became convinced—this was not a report, or a recommendation, or a finding of the Cox Committee, but my own—that our own government had as much responsibility in China's acquiring technology, which even continues to this day, as opposed to just blaming the Chinese all the time.

In fact, if my staff will hold up the chart, which I gave to every member back in the late 1990's, early 2000. This is the grand picture of China's deliberate attempt to acquire our technology, by the People's Liberation Army (PLA) and by its arms. I will make this available for any member. And what we did with this chart is, with unclassified sources, showed the connections as to how China knew the way to acquire certain technology, went about it and, in fact, were successful in many cases. And that technology covers a broad spectrum of issues, from computer technology to state-separation technology to very sensitive manufacturing technology.

You can lower the chart now.

And I will provide that for the record for members.

But besides that fact, what really offends me is that we have arms control agreements that are supposed to be put into place to stop actions when they occur by nations, and particularly the biggest proliferators: Russia, China and North Korea.

So I had the Congressional Research Service (CRS) do two studies. One was done in 1998, because that was a major issue back then. I am going to ask unanimous consent to put both of these reports into the record.

Without objection, so ordered.

The one report showed that from 1990 to 1998, under both Republican and Democrat administrations, according to the intelligence community and the State Department records, as compiled by the Congressional Research Service, we had 21 instances where China violated arms control agreements—21. Of those 21 instances that we knew about, our country imposed the required sanctions twice—two out of 21.

Now, we can sit here and complain about China being a threat, but if we are not going to take the steps to impose the required sanctions mandated by treaties, then how can we expect anything less than what has occurred?

Now, just this year I have had that report updated by Congressional Research Service. From 1998 until this year, there were 27 additional sanctionable violations of arms control treaties by China. Of those 27 times, from 1998 to today, we imposed the required sanctions 11 times.

And I will add, and I do not mean this to be partisan, but all those 11 times we imposed sanctions were after 2001.

So if you look at the past 14 years, 48 times we had information regarding sanctionable violations of arms control treaties by China. Of those 48 instances, as documented by Congressional Research Service, we imposed required sanctions 13 times, 11 of them since 2001. No wonder we have a problem.

Now, we can blame everyone else, but if we are not going to take the tough steps to deal with China, when we know that they are doing things that are unacceptable, I think we have to understand what the reality of that finding is going to be.

What are your comments on those findings?

Mr. ROBINSON. I would say that, first, it is very symptomatic of what we have seen in the economic arena, as well. If you look at the array of trade-related abuses, unfair trade practices and competitiveness issues, from intellectual property rights to the subsidies questions to currency manipulation to the artificial suppression of wages due to a lack of labor rights, and all of the opportunities that we could have brought cases to the World Trade Organization settlement dispute mechanism, how many times have we actually been to the WTO?

The answer is once, with the value-added tax on semiconductors. That is not what you call holding feet to the fire.

The same is true with our use of safeguards. We have had one, to my knowledge, very narrow use of safeguards in the textile industry, when, in fact, we have had industries that have been terribly harmed by unfair competitive practices in a number of areas.

So the long and short of it is, we buy completely, as a commission, the notion that we have not engaged in anywhere near the kind of enforcement measures and disciplining measures that are going to basically help compel China to stand up and maintain the integrity of their own commitments.

These are not things that are just out there in the air. They have made these commitments. They have basically signed on to these obligations. When they are violated on a wholesale basis, we are not enforcing them.

I think it is particularly dangerous in the areas that you have mentioned because these are militarily relevant events that can endanger U.S. forces in the future. That is the ultimate in malfeasance, when we do not hold them to account.

But the trade area and the erosion of our manufacturing base and the deterioration of our defense industrial base as a result, is becoming that kind of national security issue. And we have made a big point about the fact that economic security and national security are inseparable items, at this time.

So these would be my broad observations.

Mr. WELDON. Thank you.

Ms. Bartholomew.

Ms. BARTHOLOMEW. Mr. Weldon, thank you. And I am certainly very aware of your leadership on halting the proliferation of weapons of mass destruction and missile technology. So I think your points are extremely important ones.

I would only point out, in our report, from page 136 to page 145 or so, we list current U.S. sanctions on the People's Republic of China (PRC), and we also go through and list China's missile technology exports from 1980 until today.

I think another reason the issue that you raise is so important, is the message that is sends to other countries who are considering proliferating weapons-of-mass-destruction technology. They can basically point to China and say, "Look, the U.S. is not doing anything about that. Why should we be worried about it?" So it makes the world a much more dangerous place.

It is a problem that has crossed administrations. I think it is a problem going back at least 10 years. And too often I think that actions in one aspect of the U.S.-China relationship are essentially held hostage to another one. So people might not be imposing sanctions on proliferation of missile technology because there are concerns that it would have an adverse impact on a business deal, or something like that.

But the reality is, if halting the proliferation of weapons of mass destruction is important to this nation, which it must be, we cannot continue the pattern that you are talking about.

Mr. WELDON. I thank you. And I did read those sections, Chapter Five in particular on proliferation. You did an excellent job, and your points are very much on the mark and hopefully will stir some debate in the Congress.

What really intrigues me is that we allow weapons-of-mass-destruction technology to go unchecked by not imposing required sanctions. And yet, at the same time, with this huge imbalance of trade we have with China, the munitions list has some items on it that are perhaps not as sensitive as state-separation technology or as supercomputing technology. Yet, for instance, basic helicopters cannot be sold to China because they are on the munitions list, yet we have allowed some of this most sensitive technology to go to China. And even when we have caught them proliferating, we do not really take the steps to deal with it. So we are not really benefiting economically.

Have you looked at the munitions list and perhaps whether or not the process of putting items on the munitions list is, in fact, valid or whether or not that needs to be looked at? Was that one of the areas that you focused on?

Mr. ROBINSON. It is very much intended to be part of our forward work program, as we call it, for next year. We basically have not gone through, systematically, the munitions list and tried to ascertain whether it is, shall we say, not only up to date, but are we missing critical technologies, as you mentioned, and having more benign items on there?

We will take you up on that challenge, though, and we certainly will look at it.

Mr. WELDON. Just before I go over to vote, we only have three minutes left, I just want to set for the record, I am not an enemy of China. I have been to China. I have voted for normal trading status on a number of occasions. In fact, I spoke at the National Defense University of the PLA twice in Beijing. I think I am the only official invited to do that from this Congress.

And I voted against my colleague Mr. Ryun's amendment recently on the House floor that I thought would perhaps tweak the Chinese.

I want good relations, but those relations have to be based on transparency and on candor and consistency.

When we allow it to diverge, we send mixed signals. And I think that, in the end, causes the problems, some of which we are experiencing today.

I apologize for us having to run over, but we will be back, so enjoy yourself, and we will return hopefully in less than an hour.

Mr. ROBINSON. Thank you.

Ms. BARTHOLOMEW. Thank you.

[Recess.]

Mr. WELDON. The committee will come to order.

Again, Chairman Hunter is tied up in another meeting, so I told him I would start the session for us. Again, we apologize for that time delay, but unfortunately we had to take the five votes.

Just one final question, before we move on to our colleagues, for both of you.

In your section, Chapter Five, you went in to some of the discussion relative to Chinese support for us on North Korea and the effort to try to have them play a role, and that is, to me, critically important. I know some of my colleagues are going to want to talk about that.

On page 123 you say, "China's efforts to convene the six-party talks are a commendable preliminary step, but Beijing does not appear to have used its substantial leverage to persuade North Korea to dismantle all elements of its nuclear weapons program." And I agree with that.

Do you have any suggestions on what we can do to get the Chinese to play a more aggressive role? Should we use trade? I mean, what are the tools? Is it just basically diplomacy?

What kinds of ideas do you have that you think could be available to us to accomplish what you have laid out for us, which I agree with totally?

Mr. ROBINSON. Well, first, Mr. Chairman, I think we need to take an inventory of what kind of leverage China has in this pivotal role that it is playing as an intermediary in the six-party talks.

For example, it provides some 90 percent of the fuel to North Korea, 40 percent of the food. Thirty-five percent of its foreign aid budget annually is dedicated to Pyongyang. They have strong military-to-military and other political ties of long standing.

So, as we can see, there are a number of different arenas that China could act in if they wished. Now, nobody is suggesting food as a weapon here, for example. But fuel and military-to-military ties and foreign aid, that is maybe a different matter.

The point here is that, if you look hard at what China is supporting and not supporting, I do not see Beijing stepping up to the Pro-

liferation Security Initiative. I do not see their support for economic sanctions in any eventuality, at least to date. They are not anxious for this to come to the U.N. Security Council, as you know.

And the question that I think we first need to pose is, are we on the same sheet of music here?

I mean, it has been discussed again and again that we welcome China's posture of seeking a non-nuclearized Korean Peninsula or denuclearized, and of course that is laudable.

But is Beijing prepared to see a nuclear North Korea at some level? I personally believe they are.

And I think that most of the commissioners, my fellow commissioners, would agree with the assessment, that we are very concerned that there is not a genuine alignment between Chinese interests in the Korean nuclear crisis and those of the United States. That is for sure, in our view, and that is why we were so concerned.

And the second is, are they willing to step up and take the hard decisions? We can hold six-party talks, and have for months and months, but show me the concrete progress and achievement there. That has been elusive, and I think it will remain elusive.

There is always the risk of the parties involved being broken off. You are starting to hear about South Korea and China having a separate set of demarches to North Korea. Japan has very real concerns that are not going to wait because they are under the footprint of those missiles.

We think it is urgent. And frankly, we are not as impressed as to the level of effort being exercised by Beijing, particularly when you look at what they could be doing.

Mr. WELDON. I tend to agree with that. We took five members of this committee into North Korea. And the day before we went, a year ago, Hu Jintao and Putin both made a statement, I think it was May 28th, that both China and Russia wanted a nuclear-free peninsula, which you just alluded to.

But if you look at what is actually happening and then China making statements like, "Well, we are not sure that that means that North Korea cannot have a nuclear energy program" or some other statements, it looks to me like they are not being consistent in their own approach.

What would be helpful—and I do not know whether it is in the capability of this group, but I would hope you would be willing to do this—is maybe come up with some suggestions for us on ideas of what additional items or actions that you feel that we could be pressing the Chinese on relative to North Korea. I know I would certainly be interested in that.

And also in your document, you even talk about the continued transfer of technology through Chinese ports that benefits North Korea. That, too, is unacceptable, and that also should be stopped.

Mr. ROBINSON. Just one further comment, Mr. Chairman. We basically believe that we need to come up, as a nation, with a kind of concrete road map or proposal on the table at this juncture that tests China, not to mention Pyongyang. It tests our regional partners, because this issue is not waiting. You know better than most that they are fabricating one nuclear weapon practically a month.

When the Taep'o-dong–2 Intercontinental Ballistic Missile (ICBM) is deployed, the continental United States itself can be at risk. Now, who is going to tell me whether that is 12 months, 18 months?

We have always been surprised on the wrong side of the equation with the speed with which these countries are able to field these missiles. The Taep'o-dong–1 overflight to Japan, 3,500 miles, was a surprise to this nation.

I do not want to wait for the Taep'o-dong–2, and I know you do not.

Mr. SKELTON. Mr. Chairman.

Mr. WELDON. The Chair recognizes the gentleman.

Mr. SKELTON. Could I ask, what kind of test? Do you have a suggestion?

Mr. ROBINSON. We do not have a full-up set of recommendations for U.S. policy on how to manage this nuclear crisis.

I will say that we certainly would be delighted to pick up on the Chairman's request that we look into the more specific matters as to what could be put on the table, because we certainly think the timing is right.

One of them, obviously, has to do with the robust immediate implementation of the Proliferation Security Initiative. I am speaking personally now, because we have not discussed this matter as a commission, but that strikes me as indicated.

We have to be close to serious economic sanctions and interdiction capability. If we are not, then it would be quite baffling.

Ms. BARTHOLOMEW. Mr. Weldon, I am going to take this question from a slightly different angle, first, I think by starting and saying that for at least the past 10 years, of course, as Congress has gone through debates on U.S.-China policy, Members of Congress have been told that the Administration, this Administration, the previous Administration, could not pressure China on certain kinds of issues because we needed the assistance of the Chinese government on North Korea.

And I remember that going back to 1992, why we should not be pressuring them on human rights because we need their help on North Korea.

And it seems to me that part of the problem is we hold the Chinese government to such a low bar, in terms of what their help is. I mean, for a number of years I do not think we were getting any help at all, but people kept saying, "Well, we need their help." And now people are saying, "Well, they are helping." But really the question is, how much help are they actually providing?

I think some of it is, frankly, a reflection of dissension within the administration about what U.S. policy toward North Korea should be and how we move forward with the discussions.

But I would just like to point out a missed opportunity. My former boss, Ms. Pelosi, used to like to say, "Some people never miss an opportunity to miss an opportunity." And State Department Spokesman Boucher this morning was asked about the commission's report and asked about North Korea. And his comment was, "We certainly have appreciated Chinese efforts to organize the talks." And then he closes by saying, "The administration's view

has been and continues to be that we appreciate all the efforts China has made."

Now, of course, that would have been an opportunity to say, "Well, we think it is good that China has done this, but we have expectations that they will be doing more." And so, there is an opportunity where, with more firm diplomacy and a clearer sense of what we were really trying to accomplish and how to get there, I think that it would help.

Mr. WELDON. We will take that for the record and let Mr. Boucher know that he needs to rethink his statement. I agree with you.

With that, we will turn to our good friend from Texas, Mr. Ortiz.

Mr. ORTIZ. Thank you, Mr. Chairman.

You know, we have become so accustomed to say that we need to respect the one-China policy and that we have a one-China policy. How are we bound? Or what restrictions do we have?

Because I think, Mr. Chairman, you mentioned a few moments ago that there are 500-some-odd missiles pointing at Taiwan, and 75 added each year.

But under this one-China policy, what can we do as a committee? What is the scope of this one-China policy?

Mr. ROBINSON. Well, when we talked about making a fresh assessment of the one-China policy, as I mentioned earlier, we were not necessarily trying to prejudge any kind of outcome. We certainly also were not suggesting that this policy has not served to keep the peace for 25 years.

But at the same time, we are looking at its component parts, as you have indicated. Because, within the rubric of the one-China policy, there are things that we believe can be done.

For example, we had a chance to take a new look, given these harsh realities on the ground, at our level of defense-related assistance to Taiwan. Are they maintaining a proper level of balance with this new offensive force structure being rated against it by Beijing? The answer to that is, in our view, no. But we need to step up to that issue.

The second is the isolation policy. That is to say, China is seeking to diplomatically, economically and politically—economically, in particular—isolate Taiwan. I think, to date, we have not engaged sufficiently to ensure that that isolation strategy is not successful. I think that increases, rather than decreases, the prospect for instability and potential conflict.

And finally, it is a matter of the U.S. stepping in and facilitating the cross-Strait dialogue to a greater extent. We have had somewhat of a hands-off approach, allowing the two sides to manage the relationship.

Well, we do not disagree that it is the two sides that should take primary responsibility for their own relationship. But at the same time, the prospects for miscalculation are so evident and so debilitating if they should occur, and the chance of American blood and treasure becoming enmeshed in this kind of conflict are so high, that we simply cannot stand on the sidelines to see any sort of downward spiral in the cross-Strait relationship.

So that is really what I believe the commission was getting to and thinking about and discussing when we talked about the one-

China policy versus the new realities and dynamics on the ground, trying to figure out, what are some of the concrete actions that this committee could consider, and others, that are actionable and within and consistent with the preservation of the one-China policy as well?

Mr. ORTIZ. Another question that I would like to ask is, and sometimes members ask us, what is our commitment to Taiwan?

Mr. ROBINSON. Well, it is the Taiwan Relations Act, as you know, is the centerpiece of that commitment. And I was taking note of the fact that Jim Kelly, Assistant Secretary of State for the Asia-Pacific region, just reiterated recently, before the House International Relations Committee on April 22, the core principles of our policy.

And he made plain that the U.S., of course, is committed to the one-China policy based on the three communiques in the Taiwan Relations Act; that we do not support independence for Taiwan or unilateral moves that would change the status quo as we define it; that for Beijing this means no use of force or threat to use force against Taiwan; and for Taipei it means exercising prudence in managing all aspects of the cross-Strait relations.

For both sides, he goes on, it means no statements or actions that would unilaterally alter Taiwan's status; that the U.S. will continue to sell, or continue the sale of, appropriate defensive military equipment to Taiwan in accordance with the Taiwan Relations Act; and viewing any use of force against Taiwan with grave concern, we will maintain the capacity of the United States to resist any resort to force or other forms of coercion against Taiwan.

Now, I think that represents what the State Department calls our core principles. And I am sorry to go on a bit on that, but I think it is a very good encapsulation of what our commitment is today.

Mr. WELDON. Will the gentleman yield?

Mr. ORTIZ. Yes, my friend.

Mr. WELDON. Following up with what Solomon asked, you have given us the Taiwan Relations Act and I guess there were six assurances that were provided going back over time.

But I believe it was in your report or a summary that I read some place where there were some other secret understandings between the U.S. and China. Can you expand upon those and what they involve, if that in fact is the case?

Mr. ROBINSON. Well, this is something that the commission recommended that we seek, to the extent that they are available. We were to understand, from sources that we have talked to, that there are documents that have not yet seen the light of day from various administrations, including the Reagan administration.

One that I know a little more about, has to do with a letter or something from the President very soon after signing a Taiwan-related arms document in 1982 about ensuring that a change in the military balance was not going to disadvantage Taiwan unduly and that, in effect, we would step up to whatever challenge we should face if this military imbalance became too draconian or lopsided.

Now, that is a vast paraphrase, and I am just dealing with what I understand to be representative of the tone of some of these things.

So without being authoritative on the matter, we were just trying to see if we could not free up from the archives, so to speak, or from whatever desk they may be in, if there are any documents that would help inform our deliberations on U.S.-Taiwan relations today, as it is becoming more perilous and complex.

So it is really, in a sense, a solicitation by the commission for such documents. If they exist, it would probably be useful to see them.

Mr. ORTIZ. I would like to see a smooth, peaceful reunification. I have many friends in Taiwan, many friends in China. I frequently go to both countries.

Chairman Weldon and I and a group of this committee went to China about 5, 6 years ago. He was able to set up a meeting where we spoke to the War College. And we had a wonderful interaction with some of the military people, and it was right after 9/11.

I think what I would like to do is to encourage this committee to interact more with the Chinese and the Taiwanese and pray to God that there will be a peaceful reunification.

And, Mr. Chairman, thank you for your time.

Mr. WELDON. I thank the gentleman.

The distinguished gentleman from Kansas, Mr. Ryun, is recognized.

Mr. RYUN. Mr. Chairman, thank you very much.

Chairman Robinson and Commissioner Bartholomew, I want to thank you for your work, and the report you put together for Congress. I know I can say for others on the committee, we greatly appreciate your work.

I would like to direct my question to you, Chairman Robinson, with regard to U.S. Government restrictions on current travel to Taiwan at this point. General and flag officers as well as from the Defense Department, Deputy Assistant Secretary and the above, are restricted in their travel to Taiwan.

I worked to insert some language into the 2005 National Defense Authorization, at least the House version, that would address this policy, somewhat changing it, so that you could conduct senior military officers and senior DOD officers in an educational exchange. And the intent was really to give Taiwan the opportunity to improve its defenses against the People's Liberation Army.

The educational exchange was designed with that in mind. And I really wanted to see if you had any comments in terms of how that might provide some balance in the relationship between China and Taiwan.

Mr. ROBINSON. Well, thank you for your question.

I would point to Chapter Four of our report, which is entitled "China's Regional, Economic and Security Impacts on the Challenges of Hong Kong and Taiwan." And under cross-Strait issues, we have the following recommendation that I think broadly fits some of your concerns.

We posed the question whether changes may be needed in the way the U.S. Government coordinates its defense assistance to Taiwan, including the need for an enhanced operating relationship between the U.S. and Taiwan defense officials and the establishment of a U.S.-Taiwan hotline for dealing with crisis situations.

So taking that broad statement, I would say that although we did not specifically deliberate on this matter, that generally speaking, the commission feels that an upgrading of military-to-military contacts between the United States and Taiwan is warranted and helpful.

And again, you know, I am out a little bit on a limb on that, in a sense that it was not a specific discussion, but it certainly was the direction that I felt we are moving in. And I am quite confident about that statement.

And I think that, given the new realities, having five officers involved, having our more senior military officials able to have rich exchanges, of the types that were described by your colleague, with their Taiwan counterparts would be a force for stability and peace in the cross-Strait relationship.

So we would, I believe—I certainly can say personally, that I would support that endeavor. And I think that as a commission we would be very sympathetic to that as well.

Mr. RYUN. My second question relates to the TRA and——

Ms. BARTHOLOMEW. If you do not mind, I would just like to add one thing——

Mr. RYUN. Please do.

Ms. BARTHOLOMEW [continuing]. Which is that I recognize that there is concern even here in the committee about upsetting the diplomatic apple cart and how we manage something like that.

It does seem that one of the lessons that should have been learned about Iraq, of course, is that planning for worst-case scenarios is something that our military needs to be doing and something that people need to be thinking of.

And I think that, while we all certainly hope that we end up with no military conflict in the cross-Straits region, that we are hampering the ability for such a conflict to be conducted successfully if we do not allow some sorts of exchanges at a high enough level.

Thank you.

Mr. RYUN. I wanted to ask a second question with regard to the TRA. I know we have been discussing it some.

Do you see anything else that we should be doing as a country, say, our government, in terms of enhancing that relationship, any other suggestions?

I know you were looking for some documents and you have made some comments, Ms. Bartholomew, about some recommendations.

Anything that you see that we could do to enhance that relationship, Taiwan Relations Act, anything that would improve it, that we could move forward with it?

Mr. ROBINSON. Well, I guess it is a matter of how we interpret and act on it. It certainly gives us a fair amount of latitude to take what steps are indicated to maintain the balance.

And I think that when we talk about trying to unearth all relevant past government documents, that is more of an educational issue. But it is also quite relevant to today, because it would be useful to make sure that we understand the entirety of the evolution of U.S.-Taiwan relations, because this is such a nuanced, sensitive business that these documents can be quite relevant.

The second point is, as you know, ending or doing more to end that economic isolation strategy of Beijing, I think, is important.

And the enhanced defense-related assistance in all of its dimensions, possibly including more senior military-to-military ties, these are among the most important suggestions, and again, a more activist American posture in terms of cross-Strait relations more broadly.

Yes, the transportation links between Beijing and Taiwan are starting to slowly evolve, but too slowly. This is the kind of thing that would perhaps represent confidence-building measures that would enhance the prospects for peaceful resolution of differences, which is our official policy.

Ms. BARTHOLOMEW. And if I just might step out of the military context for a moment, there are a number of things, of course, that the United States can do, some of which the Congress has been on record supporting, which is Taiwan's participation in the World Health Organization (WHO), for example.

Encouraging Taiwan's participation and encouraging the Chinese government's acceptance of Chinese participation in multilateral organizations is a very important step in breaking Taiwan's isolation.

One of the things we really found when we were there is that certainly we know that the Chinese government has been effective in terms of doing, I would say, dollar diplomacy—of course, they are not using dollars—around the world to buy support for the government of China while reducing support for the government of Taiwan.

The Taiwanese, of course, engage in the same behaviors; they just do not have the resources and the heft that the Chinese have been using.

But the economic isolation of Taiwan is becoming a serious concern in terms of its being used as a platform in the region. It is losing its viability in terms of that.

But to go back to the multilateral issues, I think there are a number of organizations in which the Taiwanese could be playing an important role. They would like to be playing that role, but sometimes people feel restricted in the ability to encourage that because of the bigger dynamic that is going on.

Several of us went to have some meetings with the WTO in Geneva in December, and I was struck by the diplomatic maneuvering that is going on. China and Taiwan came in, of course, virtually simultaneously into the WTO. And yet there are all sorts of dynamics going on underneath the radar screen, where the Chinese are complaining about the kind of status that Taiwan is getting, the diplomatic status that the Swiss are granting the Taiwanese.

And these are the very sorts of dynamics that we had hoped would not be taking place, that the WTO would be an organization where China and Taiwan could learn to work out some of its problems without this kind of maneuvering.

So there are a number of places, I think, this government could be doing things to facilitate that.

Mr. RYUN. Thank you very much.

Mr. WELDON. Thank you, gentleman.

Dr. Snyder is recognized.

Dr. SNYDER. Thank you, Mr. Chairman.

Ms. Bartholomew, in your response, I think to Mr. Ryun, your specific words, "Exchanges at the higher military level should be allowed." Your word was "allowed."

Under current law they are allowed, are they not?

What we have been discussing in the committee is mandating certain exchanges. But we are in agreement that if the President or Secretary Rumsfeld wanted General Myers or the Joint Chiefs to have exchanges, they are completely legal under current statute. Are we in agreement?

Ms. BARTHOLOMEW. Yes.

Dr. SNYDER. Thank you.

Ms. BARTHOLOMEW. And, in fact, it was a poor choice of words on my part. The issue, of course, is how one gets an administration to do something that it does not want to do. It is different from them being forbidden from doing something.

Dr. SNYDER. I understand.

You mentioned Taiwan. I had worked as a doctor in Sierra Leone, in West Africa, for some years and visited Liberia. And one of the things that has aggravated me the last several years is, as much as we have spent talking about defense of Taiwan and all our issues with Taiwan, is that Taiwan has been one of the most aggressive supporters of Charles Taylor in Liberia, including welcoming him as, in their words, I think, as a "voice of democracy in Africa."

Well, Charles Taylor was a butcher. He is wanted for war crimes. He was probably involved in diamond trade and has supported terrorism.

Did your commission spend any time evaluating some of the policies of Taiwan and its impact on our national and economic security?

Ms. BARTHOLOMEW. To this point, Mr. Snyder, we actually——

Dr. SNYDER. Let me put it this way. We just got this book this morning. Is there anything in this report referencing that issue of Taiwanese issues impacting on our national and economic security in a negative way?

Ms. BARTHOLOMEW. No, I do not believe that we did that, but this is something that we can certainly look into in the next cycle. Several of us have been involved separately on the diamonds issue.

I mean, I completely agree with you. It is quite inappropriate that the Taiwanese government is praising Charles Taylor.

Dr. SNYDER. One of the sentences you make on page three of this summary report, I am just going to read it. This is in regard to economics. You say, "Improving U.S. economic competitiveness and the welfare of U.S. workers will require actions including enhanced national commitments education, infrastructure modernization, changes in U.S. tax policy to encourage U.S.-based production and research and development and to more comprehensive retraining programs for U.S. workers negatively impacted by trade," which I agree with everything in there.

One of the concerns I have—maybe it is an election-year concern—is that somehow we are going to send the word to the American people that there is a few magic legislative fixes out there and the economic competition of India and China and Singapore and Indonesia, they are going to go away. And they are not.

In fact, is it a fair statement to say that what China is doing and India is doing, as far as their economy, they are copying us, where we always had wanted them to do 25 and 30 years ago, have lifted hundreds of millions of people out of poverty and they ain't going to go away. There is not a simple legislative fix to this economic competitiveness. Is that a fair statement?

Ms. BARTHOLOMEW. Well, a couple of comments on there.

Of course the Chinese and the Indians, they are doing what they have every right to do, in terms of building their own economies. It is always a challenge, from the perspective, I think, of the United States, especially the United States people, who have been very generous in terms of humanitarian assistance and development assistance, to try to get to some sort of balance of, we want other people to have decent standards of living, but when it is coming at the cost of our workers, how do we handle that balance?

We did have a field hearing this year down in Columbia, South Carolina, for those of us who have worked on job loss issues. It was very sobering to actually go right out into the districts and talk to people and see what is happening in communities and the impact.

Dr. SNYDER. I am a district in the South that has had job losses and factories close, and we can hold the hearings and have the discussions with workers. My concern is that we somehow send the message that there is a simple, magical fix. And there is not.

I want to go onto another issue, if I might.

Ms. BARTHOLOMEW. Could I just make——

Dr. SNYDER. Let me touch on a couple of things, and if we have time, you can get your comments in at the end.

One is that you discussed on a couple of pages in the report the current amount of money that China is putting in their defense budget. And you specifically mentioned, I think it was the 2002 number for China, their procurement budget of $6.9 billion and that it has had a fairly dramatic rise over the last decade or so.

Now, I am trying to put myself in the position of, if I were in the Chinese military and I look at what is going on in my neighborhood, with having had a war with India, India a nuclear power; having had a war with Russia, Russia a nuclear power; the tensions with Taiwan and the tensions with the United States; and they look at the U.S. procurement budget alone, I think in our bill this year it is $76 billion.

So theirs is $6.9 billion, their procurement budget. And the Chinese procurement number, there is some inaccuracy. I think there is a lot of guesstimation on it.

I just want to mention that. I think that large, great nations historically have wanted to have a well-functioning military. And so the point I want you to respond to is, is it not inappropriate for them to build their military. Is that a fair statement?

Ms. BARTHOLOMEW. I would agree that it is not inappropriate for them to build their military.

Dr. SNYDER. Yes.

My last question, I wanted to ask a question about the floating of the yuan. I guess I get jumpy about this report suggesting that somehow we legislate something with regard to the floating of the yuan, and maybe that is what we have to do.

Did you have any minority report, not having read the full report because we just got it?

I have read some commentators that have some apprehensions that if China were to immediately go to a free-floating yuan, that that could have some negative impact, not only on them, but on us.

And I get jumpy then if I think we are going to try to legislate something here that when I think what we have to have is a fair nuance and a steady hand at the tiller of these things, that perhaps not aggravated by legislation that would control or mandate that.

Were there some folks who expressed that kind of concern?

Ms. BARTHOLOMEW. Yes, indeed, there were.

And first, I would like to say that we actually are not advocating that the yuan be floated right now. We recognize that there are some very serious problems. Conservative estimates are that 40 percent of China's bank loans are nonperforming, and the consequences for going to a free float right now are quite serious.

I would say that even Fred Bergsten of the Institute for International Economics, who testified before us, spoke on behalf of a revaluation at this stage.

Now, there is some disputes or questions about how much that revaluation should be. Some people think in the range of 15 to 25 percent would be an appropriate change for it to happen. But right now certainly we are not advocating that it go to a free float.

If I could just make comments back on some of your earlier comments.

In terms of the magic bullet, we absolutely agree with you that there is no magic bullet for dealing with the economic challenges that this nation faces. We had a number of debates among us, as to how far we were going to go on issues on which we believed that we really did not have the expertise.

Personally I believe that we have to deal with the education challenges facing the people of this nation, starting at the elementary school level and, frankly, even going to Head Start in some places.

What we have is a challenge of globalization, of which China is a part and of which the United States can be. We have the talent. We just need to make sure our people have the skills that they need in order to meet those challenges.

Again, we did not go into specifics on that because it was going beyond what we thought our mandate was.

And on the issue of the military, I think what I would like to say about that is, of course we believe that people have the right to have a sound military. The question that we always face is, what are the consequences for China's military buildup in terms of the United States, and how do we need to be preparing for that?

Dr. SNYDER. Thank you, Mr. Chairman.

I agree with your comments about education.

Mr. WELDON. I thank the gentleman.

Dr. Gingrey is recognized.

Dr. GINGREY. Thank you, Mr. Chairman.

And, Chairman Robinson, Commissioner Bartholomew, thank you very much for your testimony.

The commission concluded that China continues to assist countries of concern with their weapons-of-mass-destruction program

despite the threat of United States sanctions and related promises to halt such activities.

What role has the Chinese government assumed, if any, to halt the illegal flow of weapons-of-mass-destruction technology?

And also, what, if any, changes in United States policy should Congress consider to help curb China's proliferation of weapons of mass destruction?

Mr. ROBINSON. Well, obviously the proliferation and trafficking of weapons of mass destruction has to be one of the top priorities, if not the top priority, of the U.S. national security community today.

We were discouraged to learn in our analysis that China continues to play a role in the proliferation of both weapons-of-mass-destruction components and materials as well as ballistic missile, missiles and technology.

We have a number of recommendations.

One of the concerns we have had is that we oftentimes sanction companies, state-owned enterprises. And the nature of those sanctions are sometimes, for example, prohibiting them from doing business with the U.S. Government. Well, of course, the small fly in the ointment is none of them are doing business with the U.S. Government, and so we end up with, in the vernacular, a "nothing ball" in terms of an actual penalty.

On the other hand, to the credit of Under Secretary John Bolton and some in this administration, the last set of proliferation sanctions, for example, against China North Industries Corp (NORINCO) I believe it is the acronym for—were very serious. For example, they were, as I understand it, the imposition of import controls, which denied Norinco the entirety of the U.S. marketplace.

Now, that constitutes a serious economic sanction, as one who used to administer these things at the National Security Council (NSC) under President Reagan.

But even then, interestingly, we found in a sense a loophole, which is that although no one in the United States is legally able to traffic or import Norinco's goods and services, at the same time, it is still possible for U.S. institutional investors to buy Norinco stock and hold it in portfolio from the Shenzhen and Shanghai stock exchanges.

So there is an inconsistency there. If you are trading your stock—and when you buy a company stock, as you know, you are financing that company.

Dr. GINGREY. Let me interrupt you just for a second, because I realize my time is getting pretty short. And I thank you for that response.

And, Commissioner Bartholomew, you may want to comment on that, as well.

And I just wanted a quick follow-up, in regard to the global war on terrorism. What are the Chinese doing, if anything, to help us in that?

Ms. BARTHOLOMEW. Excellent question, both of them, I think.

We are being told, of course, that the Chinese government is being cooperative in the global war on terrorism. I think that it would behoove this committee to actually inquire about the specifics of that.

There is concern in the human-rights community that the Chinese cooperation in the global war on terrorism is the excuse that the Chinese are using to do a crackdown on the Uighurs, the Muslim population in Xinjiang province.

How much the cooperation goes beyond that, I do not know. And I think that it certainly is something that people have a right to be asking about and need to know.

I just wanted to make a comment on your question about proliferation. I think, in a lot of ways, it can be characterized as the same issue of promises made and promises broken, which is that the Chinese government often signs agreements saying that it will stop the proliferation of weapons of mass destruction and always points to those on the national level and says, "Well, look, we have put policies in place."

And then what people say is, "But the proliferation that is taking place is being done at the local level where we do not have control and/or it is companies that we do not have control over."

Two points about that.

One of which is, many of the companies that are involved in the proliferation are state-owned enterprises or were formerly state-owned enterprises. They is a very close nexus between people who are in the military or formerly in the military and the people who are running those companies; often they are the same, one and the same.

And the second one is that it has been estimated that there are at least 30,000 people in China whose responsibility is to be monitoring Internet usage to make sure that people are not going to web sites, like, for example, *The New York Times*, Human Rights Watch, web sites like that the Chinese government does not want its people to have access to.

It is very difficult for me to believe that if they can have 30,000 people who are tracking internet usage, they could not be putting resources to work stopping companies who are doing the proliferation of weapons of mass destruction.

Dr. GINGREY. Thank you very much. And just in closing, this is one report I definitely plan to read. And thank you. I think it looks good.

Mr. WELDON. Mr. Langevin is recognized for five minutes.

Mr. LANGEVIN. Thank you, Mr. Chairman.

I want to thank you both for being here and the fine work that you have done on this report. I look forward to reading both the summary you have provided and also the report itself.

I guess I would like to start with my first question going back to something Mr. Skelton had addressed earlier.

During the Cold War, it was clear that the Soviets were interested in expansion, domination and the spread of communism. And so my question would be, going back to Mr. Skelton's question, what is motivating the Chinese, where do you see them going, again, over the next decade? What is their primary motivation right now?

Mr. ROBINSON. Let me take a just a quick crack at that, and then I will move to my colleague.

China is clearly interested in a placid pond for a period of time. They are in a charm offensive, a diplomatic-economic offensive, if

you will, that is seeking to secure their position as an economic leader in the region through multilateral organizations and the like.

They are aware that they are sucking up some 46 percent of foreign direct investment destined for the region today, if you include Hong Kong in that number; about 37 percent if you do not include Hong Kong. So it is the great vacuum cleaner in terms of Foreign Direct Investment (FDI), that is, in part, at the expense of their Asian neighbors.

So they obviously are very advantaged and are increasingly the platform for all forms of manufacturing and research and development. We know about that.

Leave it to say that they are looking for, without the loss of communist control and without the sacrifice of an authoritarian form of government and a one-party state, they are looking to become a full-up economic superpower that can challenge the United States toe to toe over the next 10 years or soon thereafter.

They are obviously involved in a combination of carrots and sticks with a lot of bellicose rhetoric and intimidation, concerning Taiwan. And they have been very clear in their heavy-handedness on Hong Kong for anybody whose watching.

And the fact is that they have in mind greater China being a reality sooner than later. And that is why we are so concerned about the status of the cross-Strait relationship.

You have to worry about the Taiwan complex scenario deeply over the next 5 to 10 years, at least in my personal view. And I believe that would be a commission view, as well.

So that said, they have in mind being a dominant regional power. They view us as a competitor there. Their rhetoric toward us is extremely harsh and negative, for the most part, within China.

They have a skewed view of who we are and our intentions that leads to the kind of miscalculations that, in part, was in evidence in the Hainan crisis with the EP–3. And so it is worrisome.

And the nature of their buildup, as I mentioned, is offensive in character. The thought of attacking a U.S. carrier battle group is a real idea for them. And it is not a good idea, obviously, because it is an act of war.

So there is a lot to worry about. And unfortunately, I do not think they see us co-existing in the Asia region to the extent that should be the case. And so far from being a strategic partner that is our hope, they are very much a competitor, I am afraid, for the moment.

And I think we are going to have a better day ahead when the new generations of Chinese take leadership. So actually I am kind of optimistic post–10 years from now, at least more optimistic.

But I think we are in the window of concern and volatility and fragility over the period that you are talking about.

Ms. BARTHOLOMEW. Thanks. I have a few comments. I think I have a slightly different perspective than my chairman on this.

First, I think I would want to say that there are, of course, people who have built entire careers on trying to figure out Chinese motivation in terms of their actions vis-á-vis the rest of the world.

But I think in terms of the Politburo, it is quite clear that economic development within China is one of their main priorities. But the purpose of that economic development is not only to lift the living standards of the Chinese people, but also to allow them to maintain their hold on power.

The question then becomes, to what end is that hold on power, and how do they project it vis-á-vis the rest of the world? People, of course, vary. Some people believe that the Chinese want to reduce what they see as perceived U.S. hegemony in the world. They want a multipolar world. Some people believe that the Chinese government wants the U.S. out of Asia completely.

I do not know, frankly, what the bigger motivations are. But what I do believe is that we have to be prepared one way or another, so we do not wake up one day thinking this is benign, only to find out that it is not benign. I am a big believer in sort of worst-case scenarios and trying to think through the worst-case scenarios and to try to figure out how to deal with them.

And also I think that there is enough experience now with the Chinese government participating at the multinational level that we can start seeing these patterns, patterns of joining organizations, joining agreements, but then deciding that they want the benefits of participating in it but that they do not necessarily want to have to meet the obligations. And that is a pattern that I find of particular concern.

Mr. LANGEVIN. Do you see them as trying to pursue being the dominant hegemon in the world?

Ms. BARTHOLOMEW. Right now I would not say that I see them as trying to be the dominant hegemon in the world. I think they are interested in certainly increasing their role. In Asia, definitely, but I would not go so far as to say they are looking for world domination right now.

Mr. LANGEVIN. I know my time has expired, but I did want to ask, with respect to the fact that the United States right now has in excess of a $5 trillion national debt, what percentage of that debt is held by China?

Mr. ROBINSON. Their holding of Treasury bills right now is something in the neighborhood of $300 billion. We would have to get a number for you on that. Their overall reserves are more like $400 billion now.

Mr. TAYLOR. Sir, if I may——

Mr. ROBINSON. Yes.

Mr. TAYLOR. If you do not include Hong Kong, the number is $152.

Mr. ROBINSON. In terms of reserves?

Mr. TAYLOR. As far as holding U.S. Treasury securities.

Mr. ROBINSON. Okay, thank you.

Mr. TAYLOR. You are welcome.

Mr. ROBINSON. Well, we stand corrected. But we are happy to get back to you, you know, on any kind of elaboration we can make on those numbers.

Mr. LANGEVIN. But just for the record, that is something that should concern us, the percentage of U.S. debt that is held by China.

Thank you for your answers today and your presence and the work you do. Thank you.

Mr. ROBINSON. Thank you.

The CHAIRMAN. I thank the gentleman.

The gentleman, Mr. Hostettler, is recognized for five minutes.

Mr. HOSTETTLER. I thank you, Mr. Chairman.

And thank both of you for being here today.

I have five questions. I think the first one may be somewhat involved. I hope the last four are not.

But reading from the report, I see that, "China is heavily dependent on the U.S. market, with approximately 35 percent of its exports going to the United States."

Further, the report states, "China is continuing to attract massive levels of foreign direct investment, or FDI, including $57 billion in 2003."

And it goes on to talk about the policies that are enticing foreign direct investment. And it concludes by saying, "Such policies give Chinese industry an unfair competitive advantage, thereby contributing to erosion of the U.S. manufacturing base."

My first question is, if you know roughly or can get back to us, what percentage of the overall economy of China is the U.S. export market and foreign direct investment of entities that would have otherwise taken place in the U.S.? Do you have a rough idea?

Mr. ROBINSON. We take about 35 percent of their total exports, as I understand it, and I think you mentioned that.

Mr. HOSTETTLER. Yes. Of their overall economy, domestic as well as—do we have an idea? My question is, with regard to the impact of U.S. interaction with the Chinese economy on an annual basis, do we have an idea of how much that affects the entire economy of China?

Ms. BARTHOLOMEW. Mr. Hostettler, are you asking what percentage of the overall Chinese economic activity is based on their exports to the U.S.?

Mr. HOSTETTLER. U.S. and by foreign direct investment.

Ms. BARTHOLOMEW. I think we are going to have to get back to you on the specifics of that one.

Mr. HOSTETTLER. Okay, very good. Thank you.

Secondly, would you agree that the economic vitality of a nation is directly proportional to its military capability, either actual or potential?

Mr. ROBINSON. Could you repeat the question?

Mr. HOSTETTLER. Would you agree that the economic vitality of a nation is directly proportional to its military capability, whether actual or potential?

Mr. ROBINSON. When I think about the Soviet Union, for example, it was clear to us at the time, but it is even clearer in hindsight, that their 25 percent GDP spending on military was not reflective of their economic vitality at all. Indeed, in a way, we are blessed by that miscalculation, because it helped hasten their demise.

They had a total hard currency cash flow, at least in 1982, 1983, of $32 billion a year, which was about one-third the revenues of one American company, like GM or Exxon. So they vastly overspent, and it was a skewed view.

I think that, in the case of China, it is more proportional, and their economic vitality and successes are facilitating a very robust military buildup of an offensive character, with increasingly state-of-the-art technologies and equipment.

This is why the commission is so concerned about the European Union (E.U.) proposing to lift its arms embargo. That is going to qualitatively improve an already dangerous array of Chinese weapons systems that could be, in the future, deployed and used against American forces or those of our allies. We are very concerned also about the Russian attitude of continuing to sell their state-of-the-art-systems, and Israel's past arms sales as well.

So we have recommendations on those issues that we commend to the committee's attention. So leave it to say that China's economic growth is very much being channeled in the direction of a commensurably growing military capability.

Ms. BARTHOLOMEW. And while I would say that they are related, I do not know that they are necessarily, in my mind, directly proportional.

I do think, though, a slightly different angle to your question, that it is very important to start considering economic security as an important aspect of national security; that the strength of our nation, for example, resides not only in our national security, our military capability, but also must reside in our economic security and the strength of our workforce.

Mr. HOSTETTLER. With unanimous consent, Mr. Chairman, may I have another minute?

You have actually answered one of my questions already, with regard to the contribution, if nothing else, indirectly. Is there support by the economy for a military buildup?

Another question is, outside of China obviously, what country contributes most to China's economic vitality, in your opinion?

Mr. ROBINSON. The United States, I think, without question.

Mr. HOSTETTLER. And then finally, one more question. What is China's view of the U.S.'s long-term military capability and status, relative to China?

Mr. ROBINSON. What was that again?

Mr. HOSTETTLER. What is China's long-term view of the U.S.'s military capability, as well as the status of our military versus China's?

Mr. ROBINSON. What is their view?

Mr. HOSTETTLER. Yes. Where do they think we will be in 10, 25 years, in absolute terms, and then in relative terms to China itself?

Mr. ROBINSON. I will tell you, we did not look at China's perception of where we were going and might be in that timeframe. I think it is a very interesting question, and I think we could certainly benefit by looking at it in the next reporting cycle.

But they certainly are looking at our capabilities, particularly as they are space-related and communications-related, as well as unmanned aerial vehicles, and those things that we have on the table as our cutting-edge, 21st century capabilities.

And that is why you see such a prodigious Chinese effort to engage in information warfare, for example, to develop a capability to blind our satellites and introduce viruses into our military-related computers and systems. They are very much prepared for a 21st

century conflict, particularly given their stated strategy to perfect, if you will, asymmetric warfare.

They know they cannot take us on globally, and they do not want to. What we have to be concerned about is that they are very alert to the tempo and lethality of a quick, and I mean quick, 48-, 72-hour conflict, in an effort to destabilize and, in effect, overwhelm Taiwan into a surrender scenario of some kind.

And exactly what we would bring to bear so that they can direct their resources to figuring out from command and control communications and the actual systems that they think they need to defeat in order to hit a ship or an aircraft, they are working those issues assiduously.

And I think they have a very clear idea, regrettably, as to how they want to play out their procurement, their research and development, their technology theft operations, all with the design to have, if you will, a blitzkrieg scenario unfold, vis-á-vis Taiwan, should they feel, in their own perception, that that development is warranted.

Mr. SKELTON. Mr. Chairman?

Now, what you described is force on force and not asymmetrical. Please tell us, or expand on your earlier statement that they are preparing for asymmetrical type of conflict.

Mr. ROBINSON. Well——

Mr. SKELTON. Which is everything from terrorism, guerrilla warfare, all the way back to the Indian wars.

Mr. ROBINSON. Information warfare, I think, constitutes an asymmetric capability. And the fact that they are only in need of doing a few things well in a very regional, short-timetable type of warfare, allows them to narrow their procurement and deployment activities to make them more targeted.

Their effort to, for example, blind satellites is, in my mind, an asymmetric type of warfare. The notion of trying to develop a supersonic cruise missile capability that could hit a carrier is asymmetric if you look at the cost of the missile and the cost of the carrier.

I know this is still, some would say, force on force. But I am just trying to underscore that, whereas the Soviet Union was prepared for a far broader range of military engagement across the globe, China is exceedingly focused on where we might bring forces to bear in a various scenario and how quick they can turn out the lights or confuse our capability and, in effect, move with lightning speed to try to destabilize their target of opportunity, which will probably be Taiwan in that scenario.

Mr. WELDON. I thank the gentleman.

Just as a follow-up, we are going to be holding a hearing on the unveiling of the Electromagnetic Pulse (EMP) Commission, which this committee empaneled 2 years ago. And if you want a real scenario of how they could affect Taiwan, it would be an EMP laydown that would basically obliterate all of Taiwan's information technologies (IT) capability.

And we are concerned about that for our own country, but certainly, China has a nuclear weapon, they have the capability to put it in the atmosphere, and so that would be one way that they could accomplish it.

Wasn't it true that they actually stood up a fourth wing of the PLA that just focused on cyberterrorism and cyberwarfare? I had read that someplace in the past, that they actually had a fourth wing of the military focusing on cyberwarfare.

Mr. ROBINSON. That is our information.

Mr. WELDON. Thank you.

With that, we will turn to the distinguished gentleman from Washington State, Mr. Larsen.

Mr. LARSEN. Thank you, Mr. Chairman.

This is probably a good segue for my first question. I want you to get your pens and paper ready, because I am going to provide two questions on two separate issues and just ask them, and then ask you to answer both of them.

The first set is on education. And I guess I would urge the commission to find a nexus to your mandate to explore the implications of, I think it was the National Science Foundation's report last month about the relative lack of computer science and engineering graduates that the U.S. is producing, relative to countries like China, like the United Kingdom, like Germany, for instance, but certainly like China, specifically for two reasons.

One is, there are some economists who say that 50 percent of the GDP growth since World War II is related strictly to innovation, that ability to make good things better. And that comes from people being smart and finding out how to make things better, so that you have the economic security issue.

But the second one is the implication it might have for our ability to continue to modernize our military at the rate that other countries like China might be doing as well.

So I think there is a nexus, and if you could provide, perhaps, a comment on that issue.

The second set of issues has to do with the national security issues related to North Korea.

One person has said that, when it comes to the six-party talks, we have an approach to North Korea, but we lack an approach to our regional partners. That is, our approach to North Korea is complete, verifiable, irreversible dismantlement (CVID), but we really do not have an approach to our regional partners to get them to have the urgency that we have for CVID.

And so, I was somewhat surprised that in your report, you did not discuss the North Korean refugee issue and how that plays out with Chinese interests in the six-party talks.

You have said that China, and Russia as well, but China specifically here, certainly wishes to have a nuclear-free peninsula. That does not mean to say that they want one or they care enough to really want one.

So related to the refugee issue and Chinese interests in the six-party talks, how do you think China defines security on the peninsula? And what can we do, in terms of U.S. policy, to create leverage to get them more interested in our definition of security on the peninsula?

So the first set of questions is commenting on trying to create a nexus to your mandate on the education issue, and if that is possible do, then maybe see that reflected in your next report. So that is more of a broader comment I would like from both of you.

The second is, specifically, how do you think China defines security on the peninsula, and how do we get that definition closer to how we define security on the peninsula, with regard to the six-party talks?

Ms. BARTHOLOMEW. All right, Mr. Larsen, an excellent question, and I commend you for sitting through all of this in order to get to your opportunity to question us.

Mr. LARSEN. This is my indulgence for the week, this particular hearing, so I have been looking forward to it.

Ms. BARTHOLOMEW. Thank you. I am really glad that you are here.

Certainly, you know, as I emphasized, the issue of education at all levels is obviously very important. And we did have a discussion amongst ourselves as we were working on the report, was this too domestic, was it not China-specific?

It is not China-specific in the sense that these are challenges in terms of globalization. I think we can go back and sort of revisit it to see how much we can take on.

The other thing I can suggest, of course, is that our commission was set up through legislation, and the mandate can be changed, and so that is always possible. We can talk to your staff if you want to figure out some sort of way to possibly add that to our mandate, so there is no question about that.

Mr. LARSEN. Sure.

Ms. BARTHOLOMEW. On North Korea, it is a very interesting way I think you are proposing to think about the problem. I do think that part of the problem, as I mentioned, is that there is dissension within this administration about how to handle the U.S. policy toward North Korea, and that confusion has muddied the waters a little bit.

I think, in a lot of ways, the fact that China has not done as much as we believe they could be and should be doing to solve the crisis indicates to me that it is not the crisis to them that it is to us, which gets, of course, to the issue of one of the main things they do not want, is an outpouring of North Korean refugees across the border into China.

So stability is obviously a very important issue, as the Chinese government defines it, and I think that that is one of the things.

I think if they believed that a nuclear North Korea was more of a threat to them, they would have acted more, frankly. How we bring that into convergence with what we perceive the threat is, is certainly a major challenge diplomatically.

I think that if the administration could come to a firmer decision about what it believes it needs to be doing, sort of stopping the debate within the administration about how to approach it and move forward by putting some proposals on the table—it is not enough to say we are all going to sit down and talk. What is it that we are going to do at that table in order to get to the point that we believe needs to be reached?

Mr. LARSEN. Yes.

Mr. Robinson?

Mr. ROBINSON. I would say that I am also intrigued, and I think it is very useful the way you have posed that question. I think that we should be doing more of that, trying to understand the Chinese

perception and how we could reach some kind of convergence in views here, because we are very concerned that we are on different sheets of paper entirely here.

Certainly, the refugee issue is a big one. But what we are doing to anticipate their concern, to suggest to them that, you know, we are going to be a big part of mitigating the risk of a flood of starving refugees, for example, in the event that this comes to blows, or the tensions become ratcheted up to the point where there is a sense of panic in North Korea that something indeed may go wrong, that would, I think, go some distance to ameliorating that particular concern.

But similarly, you know, I am not sure that China has in mind altering the divided status of North and South Korea. I tend to think they are reasonably happy with the fact that unification is not in the picture, and certainly unification on something akin to American terms, where South Korea obviously is the dominant and senior partner, which would inevitably be the case.

They are then thinking about, okay, what do we have? A unified, nuclear Korea in the American camp? Is that the outcome here? Probably not so appetizing to them. Maybe there are some assurances or some dialogue that can take place as to what that future scenario would look like.

Let's take uranium enrichment facility. They say that they doubt that it is there. They simply are not buying our assertion that it exists. That is in their literature, and it has been stated very recently by the Chinese.

Well, maybe this is an intelligence-sharing opportunity, if we can do so in a prudent way, which is a question mark. And I am not going to second guess our intelligence community on that, but leave it to say that we have some convincing to do, as Commissioner Bartholomew mentioned, concerning the level of the threat.

If they believe that sort of half of that nuclear equation is not in the picture, they are going to be more relaxed about this. And relaxed, I think, is something that none of us can be.

So I do not, for example, see how this crisis is going to languish on, say, beyond 2005, 2006. This is not a containment strategy, in my mind anyway, or in the commission's mind, that we are going to be dealing with 5 to 10 years from now. This is on a short tether.

And these are the kinds of dialogues, anticipatory dialogues that should be happening. It is, frankly, part of the reason that the Iraq scenario comes under some criticism. I mean, perhaps there was not as much forward planning as there might have been.

I am not going to, again, second-guess that issue either. But it is on the table today in this country, and we need to be thinking about the fact that this North Korean crisis is not going away, and what are the scenarios, and how can we ameliorate some of the principal concerns of key, pivotal players like China, so that they come on board in a timely way before this thing goes hypercritical.

Ms. BARTHOLOMEW. Mr. Chairman, could I add one thing? Because Mr. Larson also asked about the sort of lack of approach to regional partners, and I think that is an important point too, which is this is a circumstance where we need to be working with our allies in the region and our allies who are at the six-party talks with South Korea, with Japan.

We need to be understanding more, I believe, what they believe the solutions to the problem are, giving their positions more standing in our position at the table. And I think that that is an important thing the administration could be doing.

Mr. LARSEN. Thank you, Mr. Chairman.

Mr. WELDON. I thank the gentleman. If you have additional questions, we will go through another round if you want to stick around.

The gentleman from South Carolina, Mr. Wilson, is recognized.

Mr. WILSON OF SOUTH CAROLINA. Thank you, Mr. Chairman.

And, Mr. Chairman and Commissioner, thank you very much for being here today. It is particularly meaningful to me that you would be making this report of the U.S.-China Economic and Security Review Commission. This was authorized by the Floyd Spence Defense Authorization Act of 2001.

The late Congressman Spence was my predecessor, and I know that he would be very appreciative that, indeed, you are bringing information to us of the best case, worst case. And that is where we are, in trying to figure out where we are in the world, and I appreciate what you are doing.

I have also had the extraordinary opportunity, thanks to Chairman Curt Weldon, to visit Beijing. And I was on a delegation with my colleagues from this committee, Congressman Miller, Congressman Ortiz and Reyes, and we had the opportunity, amazingly enough, to visit with President Jiang Zemin. The gist of the conversation was that we have more in common than we have differences.

That was restated on the front page of *The China Daily* the next day, in English, and I was very surprised. I was equally surprised, in Beijing, to see boulevards and avenues with skyscrapers, very modern skyscrapers, filled with Jeep Cherokees and Buick LeSabres. That is not what a cold warrior, who was familiar that there was no private car ownership, I believe, until 1981, that is not what I anticipated.

But I saw economic integration that actually makes me very hopeful. And as we talk about these trade numbers, they are not entirely negative, obviously, on balance. But I would really hope that there would be economic integration for mutual benefit.

A concern I have, though, and a lot of this you have already touched on: There should be cooperation, for example, in the global war on terrorism. And it has been stated, and while we were there, they kept indicating the strongest of support for the United States in the war on terrorism.

And so, I was concerned that you all mentioned that it may not be as clear as it should be. To me, the terrorists are obviously against democracy, but they are against modernism. And I saw a very modern society, which will be very susceptible to terrorism. And, of course, you mentioned the western provinces.

The question I really have is in regard to North Korea. I had the opportunity, again, to go with Congressman Weldon last year to Pyongyang. And I have been very hopeful that the People's Republic would take a great lead in trying to limit the instability on the Korean Peninsula. It seems like to me that is against their self-in-

terest, that a destabilization of a nuclear Democratic People's Republic of Korea (DPRK) is not good.

An example, I really relate it to Severe Acute Respiratory Syndrome (SARS). They found out how that disrupted their economy. The same analogy could be used for nuclear weaponry by North Korea. So I would hope that they would really take a role.

And in particular, they are finding that DPRK is an ungrateful, forever dependency that never seems to go away. And then, the contrast with South Korea, which provides two percent of employment by way of investment in China, which is utterly struggling.

And you mentioned about the six-party talks, and I believe that we are trying to work with our allies. But what more can we do to influence the People's Republic to take a greater role in providing stability and a non-nuclear North Korea?

Mr. ROBINSON. I think that, of course, some of my answers, at least, to Mr. Larson, and I think Commissioner Bartholomew's as well, were speaking to that issue of things that we could do to ameliorate some of China's, what I believe are their pressing interests in this matter, such as refugee flows and the consequences of a unified Korean Peninsula, just for starts.

But it strikes me that our interests certainly should be aligned on this crisis. It seems self-evident to me too. And when you have a nuclearized North Korea—and they have an arsenal, some say, eight nuclear weapons today, but at one a month, I mean, by the end of the summer, what are we talking about, a dozen, 15?

They can test, they can sell nuclear materials, including plutonium, at that stage, to terrorists or rogue states. The fact is that they are also edging Japan, South Korea and arguably Taiwan, all of whom are very sophisticated technological societies, to take a hard look at whether they need to consider, in some cases like Japan's, the unthinkable, which is their own nuclearization.

China does not want a ring of nuclear power. So I must tell you, I am baffled a little as to the tradeoffs or the calculations that they appear to be making at the present time. I think that they should realize that the time for action is now.

And by the way, I know that we have sounded as though we are somehow negative to a lot of what is taking place in the U.S.-China relations. But I just remind the committee that our charge is to look at the downside risks and the shortfalls in performance that may be ahead.

We readily acknowledge that there are dramatic developments and encouraging developments in the relationship that give us a good deal of reason for hope, as well, that economic integration, although it has been slow to translate into greater political pluralism to date, and which is a deep disappointment to many of us, that that day sure could come, especially with the younger generation. So I would only add that as well.

But to answer your question, I think we can do a better job in persuading China that this is not something that is going to be a multiyear gathering effort; that we have to recognize that Japan, in particular, I do not think has more than one year left in it before it is going to start making some serious decisions.

Now, we were in Japan, we talked to senior officials in the foreign ministry and the defense agency, and leave it to say that they

are not only under the footprint of the type of Taep'o-dong–1 ICBM capability, but a couple of hundred No-Dong missiles as well that we, as a nation, do not have to worry about. They do.

And I do not think that Japan sees its way to being under that gun, literally and figuratively, a sword of Damocles or whatever analogy you want to use, for some kind of indefinite period, or even a multiyear period.

So I think that China is going to wake up and smell the coffee, as it were. I do not know that they have adequately done so. We do not feel that they have, as a commission. And we can only hope, as you do, that they understand and fully comprehend the stakes.

Ms. BARTHOLOMEW. Congressman, since the Chairman has talked about North Korea, I just want to speak briefly on the economic issues that you raised. We took our first-ever field hearing out of Washington, D.C., and went down to Columbia, South Carolina.

And I mentioned earlier, for those of us who have looked at the jobs issue for a number of years and are aware of it, it was really very sobering to speak with people in the community, people who came to Columbia to testify on behalf of Georgetown County, I think it was.

Mr. WILSON OF SOUTH CAROLINA. The steel plant there in Georgetown, right.

Ms. BARTHOLOMEW. The steel plant issues, the people in the textile industry, and the ripple effect in the economy, which you know far better than I. We heard the churches cannot help as much in the community as they would like to because people have so much less money because they have lost their jobs, they cannot contribute in the churches the way they did, and the consequences for hospitals and all of these aspects. So it is obviously very serious.

Economic integration is really important. I think over the course of the past 10 years in U.S.-China policy discussions, many people up here have been led to believe that part of the economic integration would be increased opportunities for U.S. companies and U.S. workers. The question is, has that happened?

And I am afraid that the answer really is not, when you see some of what is happening with China not complying with its WTO obligations, complying in some ways and then adding things like phytosanitary standards, tax subsidies, all sorts of other barriers that they are putting up, so that the U.S. goods and services do not have the kind of access to the Chinese market that they should be having.

And similarly, a lot of companies that are moving into China and producing both for the Chinese market and for export back here to the United States is not necessarily unfolding the way that some people believe.

So obviously, we have a lot of challenges to face. The Chinese are doing what they are doing. We just have to figure out how, with our society, we are going to have a workforce that is prepared to meet those challenges.

Mr. WILSON OF SOUTH CAROLINA. And thank you very much. And again, I am very hopeful that China realizes that it would be mutually beneficial for China, for the Korean Peninsula, for world peace

that there be a non-nuclear North Korea for the benefit of the whole world. And thank you very much.

Mr. WELDON. I thank the gentleman for his questions.

Mr. Taylor is recognized for five minutes.

Mr. TAYLOR. Thank you, Mr. Chairman.

And let me turn it around and thank you two for sticking around this long. I apologize the attendance is not a little better.

On September 11th, our nation was attacked, and obviously, the Bush administration responded very strongly to that in a number of ways. But what a lot of people seem to have forgotten is that earlier that same year, a United States Navy P–3 was also attacked.

The crew was held captive, the plane was confiscated, and when it was finally returned by the People's Republic, it was not intact, it was in pieces, after they had gone through it bit by bit.

I found our administration's response to that pretty lukewarm, maybe worse. And I am trying my best to recall a political science course way too long ago that said that almost every administration is challenged early on by a potential foe just to judge their reaction.

I guess one example of that would have been the Mayaguez with the Ford administration, fairly early in the Ford administration, but there are others. But that is the one that comes to mind. And of course, General Ford responded very forcefully to that, and the ship was recovered.

I am curious, in your work in China and study of China, what was the Chinese reaction to the Americans allowing our crew to be held captive, to allowing our plane to be held captive, and finally returned, again, not intact, but piece by piece? What was the reaction on the street?

Because there really has not been much talk of that, and I would never have an opportunity to look into that. And I was wondering if, at any point in your studies, that was broached?

Mr. ROBINSON. To be fair, we did not go back to that incident and try to, in any systematic way, ascertain Chinese perceptions, either at the leadership level or on the street. I think it would be a very instructive idea, really.

Mr. TAYLOR. If you get the opportunity——

Mr. ROBINSON. Yes, because——

Mr. TAYLOR. And I would think you will have the opportunity a lot more than I will.

Mr. ROBINSON. Yes.

Mr. TAYLOR. That I would like to know.

Mr. ROBINSON. Well, we will take that on board, because I buy entirely your reading of history here. U–2 comes to mind, KAL–007 for Reagan comes to mind.

Mr. TAYLOR. Thank you very much.

Mr. ROBINSON. I mean, these were signal, watershed events that did shape the destiny of relationships, probably to a greater extent than we know. Chernobyl was another, in a sense, a different way.

But leave it to say that I was impressed, as you were, at a personal level, by the way the Hainan incident played out. Ironically, you know, my take on it was that——

Mr. TAYLOR. I am not saying that I was necessarily impressed that we got our plane back and our crew was held captive. I was not impressed at all.

Mr. ROBINSON. No, no, when I say "impressed," I mean as in leaving an impression, not necessarily a good impression. No, I thought it was a tragic event and, frankly, a major miscalculation by the Chinese that I do not think that they paid for in any significant way.

Mr. TAYLOR. Again, I would question your word "miscalculation," because, as you said, they paid for in no way. No trade sanctions—as I recall, our administration apologized to theirs, repeatedly.

Mr. ROBINSON. Yes, I think it was reported at the time that they had some genuine confusion between the leadership and the military on that. But I take your point that if you do not pay a price, it is hard to say you miscalculated.

But leave it to say that the thing that got their attention most, in my recollection of that event, which kind of combines trade and national security in an interesting way, was the fact that you had thousands of Americans spontaneously going to Wal-Mart, K-Mart, other stores, filling their shopping carts with made-in-China goods, going to the cash register and saying to the cashier, "This is what I would have purchased had they not been made in China," and walking out.

Mr. TAYLOR. I did not hear much——

Mr. ROBINSON. That made the front page of *The New York Times*, as I recall, and our captive service people were released soon thereafter.

Now, I am not trying to suggest that that was it, that was the action-forcing event, but I will say this, that it is when the Chinese recognized the level of estrangement with average American consumers, who are their lifeblood, who take 35 percent of their exports, that the nickel dropped, that holding American hostages and cutting up their airplane and just taking every scrap of intelligence out of there was a bad idea.

I do not think they paid that price at all, I agree with you, on the government-to-government side. But thank goodness the American people spontaneously took their own actions that, I think, played a role in the resolution of that problem.

Ms. BARTHOLOMEW. Mr. Taylor, just briefly, I suppose I will take refuge in the fact that I was not a member of the commission at that time. At that time, I was actually on the staff of the House Intelligence Committee.

But one of the mandates of the commission is to look at how the Chinese government uses media control to shape perceptions of the United States. And we can ask our staff also to go back and look at that issue to find out how was it playing out publicly in China, what was the Chinese media doing to control the perceptions of the United States as it happened, as well as some of the things that you are talking about, which are more behind the scenes.

So we can get back to you in terms of what we find out about it.

Mr. TAYLOR. If I may, Mr. Chairman, since, apparently, there are only four of us left in the room. Thank you.

What is your read, either as a commission or as individuals, on the huge purchases of American debt, Treasury notes by the Chinese, which continues? I think it is now $5 billion more than it just was a handful of months ago. So it is increasing by the tune of about a billion a month.

If you are to throw in Hong Kong with what mainland China holds, they have become clearly the second-to-largest holder of American debt.

I know that my constituents, who, as a rule, frown upon foreign aid, are usually astonished when I tell them that we pay a heck of a lot more on interest to debt held by countries like China. We pay a heck of a lot more on that interest, which is actually a flow of their tax dollars, than we ever pay in foreign aid.

I think foreign aid is now $21 billion a year, and we spend in the neighborhood of $110 billion a year just paying interest on debts to foreign nations of American Treasury securities that they hold.

What is your read on why they are buying so much of our debt? What does that give them?

Mr. ROBINSON. Well, in a sense, I think a lot of it is a compliment to the security and attractiveness of Treasury bills. I mean, it is an ultimate place to put reserves. I think that is a lot of it.

Much of it stems from their artificial undervaluation of the yuan and the fact that they are running such large trade surpluses and their ability to attract such a relatively vast amount of foreign direct investment.

I think that we worried about this issue, as you know, in the 1980's, with Japan, when they had some——

Mr. TAYLOR. Which now has $600 billion of our Treasury debt.

Mr. ROBINSON. Yes. And, you know, we were worried, at one point, because the Japanese said, in the midst of a trade dispute—I cannot quite remember which one—that they were tempted to take a look at dumping their T-bills, with the view that this could increase American interest rates and create other problems for us.

I do not think that China is inclined to play that leveraging game. On the other hand, I think that this is an issue that we have to be alert to.

For example, we do have this issue as something we want to look at in the next cycle to better understand what kind of scenarios might be in the offing, as to how China could use that large T-bill set of holdings to somehow leverage their position in the United States geopolitically or otherwise.

Mr. TAYLOR. If I may——

Mr. ROBINSON. Yes.

Mr. TAYLOR [continuing]. I will throw a scenario at you. A long time ago, I was a Mississippi state senator, and a banking bill came before the body, something that was obviously in the interest of the larger banks.

And there was an extremely nasty rumor going around that one of the larger banks had taken the time to see how many legislators had mortgages with them. This was back when the interest rates were very high, so if someone demanded payment of that mortgage,

you knew that the next mortgage you got was not going to be nearly as good as the one you just lost.

Could that be a factor, the ability to call in and demand $151 billion? Could that not wreck or cause substantial reverberations in the economy if suddenly we had to find $151 billion of American investors overnight to make up, should the Chinese choose to sell their notes on a whim or for a political cause?

Again, one of the things that has kept interest rates low is the fact that foreigners have stepped up to buy one-third of our debt, and that we would have to raise the payment on Treasury securities substantially to entice Americans to buy the notes that the foreigners are now willing to buy and, apparently, the Americans are not will to buy.

Have you all looked into that? Because, again, this is playing what-if.

Mr. ROBINSON. Yes.

Mr. TAYLOR. But I have seen the Argentine government never get back on its feet from about 2 years ago, when it chose not to fulfill its financial obligations to people that it owed money to.

Mr. ROBINSON. Well, I think we are in the what-if business.

Mr. TAYLOR. I think that is precisely our job.

Mr. ROBINSON. And I further think that it does merit the commission's attention, now that we are starting our third reporting cycle just now. We are already in the midst of planning for next year's report. So we will certainly take on board the idea of trying to develop our thinking and scenarios on the reserves.

I take your point. The level of disruption is hard to gauge, as you can imagine, exactly whether this would—I mean, the quantitative impact of what it would do to interest rates, for example, or what it would do the price of T-bills, and how attractive we need to make them to offset an offloading of that kind.

You know, it would have to be a pretty dramatic scenario. Because if I am China, and I am as dependent on the United States market, where we have, what, 3, 5 percent of our exports going to China, and they have 35 percent coming to us——

Mr. TAYLOR. Mr. Robinson, if I may, going back to your scenario of the lightning strike on Taiwan.

Mr. ROBINSON. Right.

Mr. TAYLOR. Okay, what if they manage a lightning strike on Taiwan, and they occupy Taiwan, much like the Argentines took the Falklands? Then they turn to the United States, as we are pondering what to do as a nation, and say, "By the way, if you choose to change this situation that exists right now, we want you to pay off your debt to us right now."

Would that not fit an asymmetrical threat?

Mr. ROBINSON. I think it would.

Mr. TAYLOR. The nuclear genie still stays in the bottle, even though I have, certainly, the same fears as my chairman here.

Mr. ROBINSON. I think that we are postulating here an extreme scenario, and in an extreme scenario, extreme measures are taken.

This is financially a nuclear event, when you are actually engaging in your use of T-bills as, in a sense, a weapon to disrupt the American economy. It is a serious matter. But so is a lighting strike on Taiwan with missiles and so forth.

So I take your point that there are scenarios out there. That is what information warfare and blinding satellites like that of Pacific Command are all about. So I take your point that they would look at all kinds of levers.

Indeed, I think that they would go into the currency and commodity markets knowing their attack schedule, and try to make billions, possibly tens of billions, of dollars in forward contracts to pay for the conflict, knowing the timing of what is going to happen to the markets when they attack. That is another scenario.

So I think that economics and finance would play a prominent role in this multipronged offensive, particularly of the blitzkrieg variety. And I think that it is very insightful and visionary of you, frankly, to be adding those dimensions, and we will too.

Ms. BARTHOLOMEW. Mr. Taylor, if I may, just one point, which is that what you are saying in another way, too, is that deficits do matter, and that it is not only about mortgaging our children's future, but the deficit that we have been racking up in this country has potentially all sorts of other consequences that people have not even thought through sufficiently.

Mr. TAYLOR. Has your committee looked at the simultaneous rise of the weapons modernization account in the People's Republic as their trade surplus with our nation has grown?

Because I am told there is almost a dollar-for-dollar increase. And as they showed in the Korean War, they are willing to take casualties. They can do a heck of a lot with a little. And I would think if you took that very large horse and combined it with modern weaponry, you have one heck of a potential foe.

Mr. ROBINSON. Their average increase in defense spending from 1997 to 2004, we have in our report, is 13.6 percent, whereas their average GDP growth in the same period is 8.2 percent. So defense spending is outstripping even that impressive and robust growth rate.

And as we said earlier, there is no question that their massive trade surplus with the United States is helping fund an offensive, sophisticated military buildup, in part directed against the United States. There is no question about that fact.

And the commission is urging that we not only be mindful of it, but that we have to take a whole new look at our policies in the cross-Strait relationship and beyond to account for the fact that not only is the weaponry there, but what are the intentions?

This is not necessarily an irrational-actor scenario. The level of emotion in China concerning unification with Taiwan is not trivial, and it is not altogether something that is going to be predictable or in their best interest.

They, themselves, have said many times, looking in our eyes practically, saying, "Never make the mistake that we value our economic and trade relationship with you to the extent that we are ever going to permit Taiwan to go anywhere, but to be a part of the mainland as a province."

So leave it to say that this is something we are paying a lot of attention to.

Ms. BARTHOLOMEW. One caveat, Mr. Taylor, on the numbers that our chairman just used, this chart is based on what the Chinese government says that it is spending on defense. We have no reason

to believe that they are not spending significantly more than they actually report that they are spending. So there is not transparency there.

Mr. TAYLOR. Mr. Chairman, you have been very generous, and thank you.

Mr. WELDON. No, good questions. They were an excellent line of questioning. We appreciate your sticking around, Mr. Taylor.

I would like to turn now to our distinguished Ranking Member, Mr. Skelton.

Mr. SKELTON. Mr. Chairman, thank you.

Mr. Chairman, how many members are on your commission?

Mr. ROBINSON. Eleven.

Mr. SKELTON. How many members have ever lived for a period of time in China?

Mr. ROBINSON. Two currently, and three in the life of the commission.

Mr. SKELTON. And how many of your present commission speak Chinese fluently?

Mr. ROBINSON. Okay, let me see. Two commissioners and at least two staff.

Mr. SKELTON. Thank you.

We found in the study of the Mideast problems, not necessarily limited to Iraq, a huge lack of cultural understanding and a huge lack of language understanding, despite the fact that we have a good number of former Mideastern citizens as naturalized Americans.

And I see this as an American problem, that we do not have a real cultural awareness of people with whom we are dealing, people who might well at some time be a potential adversary. And I would appreciate if, in your next round of recommendations, address the lack of our cultural understanding.

I think we have to raise the awareness of this within our country. The Far East languages are more difficult than European languages or even the Middle Eastern languages. But I think that if we are going to be more successful in international relations, we, as a country, must do a better job in this thing called cultural awareness.

And if you would not mind addressing that, I think it would help all of us to have a better understanding of the need to do it.

China is a long way away, and at best some people have visited there. And I understand that the languages in different parts of China are different. So many areas, but they all have some sort of common tie, as I understand that.

Please address that, would you, in your next round.

Mr. ROBINSON. Well, thank you for that very, very, I think, insightful suggestion. And I certainly take your point that, as a nation, we are deficient in terms of our policymaking and efforts to understand the nuances of the cultures with whom we are dealing. And we will take that on board.

Mr. SKELTON. Please do.

Mr. WELDON. Will the Ranking Member yield?

Mr. SKELTON. You bet.

Mr. WELDON. You have just made an outstanding point that I would add, from this side of the aisle, we would encourage you to pursue aggressively.

On one of my trips to China, I learned a fact that I was not aware of, that Chinese is the predominant spoken language in the world. We always think it is English. But when you look at 1.3 billion people in China, and you add in the other languages in the area, it is the number-one, spoken by people around the world.

And if I look at our schools, being a former educator, and look at the languages that we—I could not name maybe one school in my district that teaches Chinese or that teaches Arabic. And we really have a shortage here.

And the distinguished Ranking Member is right on the mark. For us to deal with these regions and countries, we would better understand their culture. We had better be more sensitive to their position and how they perceive us and how they perceive the world.

And thank goodness your commission—I am impressed with the makeup you just cited to us. It shows a sensitivity that I would not have expected, and I am pleased with that.

But I echo the Ranking Member's comments totally, and I would ask you to come out in strong terms and terms of recommendations to the Congress and this body regarding Chinese language programs, cultural exchanges, and those other things that we can do at home to help us better understand the dilemma of dealing with China.

Mr. ROBINSON. I think it is a superb suggestion, Mr. Chairman, I really do, and I think you can count on the commission being responsive to it.

Mr. SKELTON. And we will ask questions of each of the commission members and expect the answers in fluent Chinese. [Laughter.]

Mr. ROBINSON. It shall be done.

Mr. WELDON. And the distinguished Ranking Member said he will ask his questions in Chinese. [Laughter.]

The gentleman from Washington has an additional question.

Mr. LARSEN. Thank you, Mr. Chairman.

With regards to the Proliferation Security Initiative, you have about three or four paragraphs on it in your report. And given its relative newness, I can imagine three or four paragraphs is about all you could find on it. Maybe next year we can see a little bit more on it.

One thing that strikes me is that the main point you make about it, separate from North Korea, is that China, obviously, has not agreed to participate, although it has been asked. As well, China did fight against the U.N. resolution and seek changes to the U.N. resolution passed earlier this year on proliferation.

And I am just trying to think through this a little bit, perhaps for next year, looking at the reasons why, perhaps, China seems to be nervous about it. Just three quick points that I thought of is, probably Personnel Security Investigation (PSI) does certainly mean an increased naval presence, a U.S. Naval presence in the region. These trans-shipment issues, which you address elsewhere in your report, trans-shipment issues with regards to DPRK, as well as, perhaps, China's own role in the proliferation of technology.

But if we could get some additional information, maybe you could explore that issue a little bit. As large as China is, it would be useful to have them as a partner in PSI.

And then, the second set of issues, we have focused on cross-Strait issues, we have focused on North Korea, we have focused on capital flows. It was only mentioned a couple of times, and I do not want us to walk away without, I think, again, expressing concern about the potential that the E.U.'s arms embargo could be lifted. And we need to be sure that we communicate that that is a very serious issue.

Although we may not have explored it as deeply as other issues, I think it is still a critical one that we communicate.

Mr. ROBINSON. Well, we certainly take your point. You can count on the fact that we will be giving more extensive treatment to the Proliferation Security Initiative. If China does not come on board, we will talk to the issue of why in some detail, I would think. And if they do, we will certainly want to monitor their performance with that set of obligations as well.

With the E.U. arms embargo, that is coming down the pike soon. And it is not going to go positively, at least from my personal perspective.

We have suggested, indeed recommended as a commission, that this cannot be just a rhetorical issue for the United States, a matter of so-called demarches to our European allies asking for a restraint and not to lift the embargo. And if they do, then one of these throw up the hands, you know, oh well, let's move onto other issues.

We have recommended that foreign firms that engage in the sale of sensitive military-relevant equipment and technology to China, as a policy option, be barred from research, joint venture, co-production type of cooperation with the U.S. Government and U.S. defense contractors.

That can be narrowed and targeted to the areas of technology that they were engaged in selling to China. Let's take a sophisticated radar system of the type that almost went, and gratefully was stopped, from the Czech Republic, the so-called Vera system. If a radar system is sold by a firm, then it would be that area of defense cooperation that could be put at risk.

So the decision would, in effect, have to be, we can do business with China in this category or we can do business with U.S. defense contractors and government, but we are not going to be permitted to do both. Now, that is a sobering calculation. And again, we pose it for your consideration, as an option.

But it goes to the seriousness with which the commission views the fact that if this E.U. embargo is lifted and European firms start moving state of the art technologies and equipment to China, we believe that is going to translate into, or could well translate into American casualties in the not so distant future, much less further out.

And that is just, from our perspective as a commission—and we had a unanimous view on this—that's not on it.

Mr. WELDON. Excellent point. I thank the gentleman for his question and for his involvement.

And just in summary, let me say that we appreciate you being here. I would ask your staff to interact with the EMP commission on the potential of that phenomena being used as an impact in the China-Taiwan situation.

And let me just say that I think the progress of the commission is outstanding. It could not be more timely. We will make sure that, for the members that were not here, they get summaries of the report and encourage them to read it, because you provide a very valuable service in an area that I think will be our biggest challenge over the next 25 years, and that is how to deal with China in a way that brings them closer to us, yet also allows us to be sensitive to the military concerns that we have as a nation.

And I want to especially thank you personally. I know you both could be doing a lot of other things.

Mr. Robinson, you have held a lot of positions in a lot of administrations. And for you to take the time for this, as well as Ms. Bartholomew, that is a real tribute to you personally, because I know you are not getting rich off of this position.

And so, thank you for your outstanding work. Please thank the other commissioners. And we want to assure you that we appreciate the work of staff in putting this outstanding document together.

With that, the members will have a chance to add any summaries they would like to make, and we thank you for appearing.

This hearing stands adjourned.

[Whereupon, at 5:36 p.m., the committee was adjourned.]

APPENDIX

JUNE 16, 2004

PREPARED STATEMENTS SUBMITTED FOR THE RECORD

JUNE 16, 2004

OPENING REMARKS OF CHAIRMAN HUNTER

Hearing on the report of the
United States-China Economic and Security Review Commission

June 16, 2004

This afternoon the committee is pleased to take testimony from the United States-China Economic and Security Review Commission which was established by Congress to provide an in-depth and independent review of the many critical issues facing the relationship between the United States and the Peoples Republic of China.

Our witnesses are:

Mr. Roger W. Robinson, Jr.
Chairman
United States-China Economic and Security Review Commission

Ms. Carolyn Bartholomew
Commissioner
United States-China Economic and Security Review Commission

Welcome to you both. We look forward to your testimony and appreciate your appearance before the committee this afternoon.

The purpose of the permanent commission is to monitor, investigate and submit to Congress an annual report on the national security implications of the trade and economic relationship between the United States and the People's Republic of China. The commission is also charged with providing recommendations to Congress for legislative and administrative action.

It is important to note that this congressionally-mandated commission was designed to be and is completely bipartisan. There are 12 commissioners, evenly selected by the House and Senate leaderships, both majority and minority. The chairmanship, now held by Mr. Robinson, alternates between Democrat and Republican-appointed commissioners every year.

Another important feature of the commission is its broad scope. The commissioners assessed U.S.-China economic and security issues together, not separately.

This comprehensive approach is important because it underscores the interrelationship between trade and security. Trade can help advance U.S. national security interests; but it can also endanger them if it proliferates dangerous technology or undermines our strategic independence.

Yesterday, the commission released its 2004 report. Its findings, unanimously supported by the commissioners, are a wakeup call for United States policymakers concerned with both trade and national security issues.

The commission found, quote, "that a number of the current trends in U.S.-China relations have negative implications for our long-term economic and national security interests, and therefore that U.S. policies in these areas are in need of urgent attention and course corrections."

Some of the trade and security issues the commission studied include:

- China's military modernization efforts and the affect on the cross-Strait military balance;
- Its high-technology development and U.S.-China science and technology cooperation;
- Beijing's proliferation practices, especially its role in the North Korean nuclear crisis; and
- China's use of forced technology transfers in trade negotiations.

Thankfully, the commission reminds us, the United States-China relationship is still in the relatively early stages of its development. So there is still time for the Congress to work with the President and U.S. industry to correct outdated or misinformed U.S. economic and security policies.

Chairman Robinson, Ms. Bartholomew, we look forward to your testimony and to the ensuing discussion. But first, let me recognize the

committee's ranking Democrat, Mr. Skelton, for any remarks he may wish to make.

The entirety of our witnesses' prepared statements will be entered into the record. Mr. Robinson, the floor is yours.

Opening Statement for The Honorable Ike Skelton (D-MO), Ranking Member, Committee on Armed Services, U.S. House of Representatives
Full Committee Hearing on the Report of the U.S.-China Economic and Security Review Commission
June 16, 2004

Thank you, Mr. Chairman. I join you in welcoming Chairman Robinson and Ms. Bartholomew. I congratulate the entire Commission on issuing a unanimous report.

Back in April, Mr. Hunter held an issue forum with former Speaker New Gingrich and former Assistant Secretary of Defense Frank Kramer among others. What came out of that session for me is that the Taiwan Straits is among the most potentially dangerous places in the world today. And it leaves me with an abundance of caution about our policies there.

As the committee well knows over 150,000 of our troops are already engaged in operations throughout the Central Command theater

of operations in Iraq and Afghanistan. Some of those forces have begun to be pulled from Pacific Command, notably from Korea. Our hearings of the last two days and now this hearing today show collectively the need for strategic thinking about the future challenges facing the United States.

The Commission before us today has identified a number of those challenges in our multi-faceted relationship with China, but there are also opportunities in the near-term to affect real change. I look forward to the witnesses' testimony to help us understand both the dynamics and the recommendations for action.

Thank you both for being here. Mr. Chairman, thank you for holding this hearing.

DOCUMENTS SUBMITTED FOR THE RECORD

JUNE 16, 2004

2004
REPORT TO CONGRESS

of the

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

ONE HUNDRED EIGHTH CONGRESS
SECOND SESSION

JUNE 2004

Printed for the use of the
U.S.-China Economic and Security Review Commission
Available via the World Wide Web: http://www.uscc.gov

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON 2004

For sale by the Superintendent of Documents, U S Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail Stop SSOP, Washington, DC 20402–0001

Executive Summary

This Report sets forth the Commission's analysis of the U.S.-China relationship in the designated areas of investigation in our Congressional mandate: China's proliferation practices, China's economic reforms and U.S. economic transfers to China, China's energy needs, Chinese firms' access to the U.S. capital markets, U.S. investments into China, China's economic and security impacts in Asia, U.S.-China bilateral programs and agreements, China's record of compliance with its World Trade Organization (WTO) commitments, and the Chinese government's media control efforts. Our analysis, along with recommendations to the Congress for addressing identified concerns, is chronicled in the Report's nine chapters, and summarized herein.

Overall Assessment of Economic and Security Challenges

Along with specified areas of investigation, Congress gave the Commission the overarching mission of evaluating on an annual basis "the national security implications of the bilateral trade and economic relationship between the United States and the People's Republic of China (PRC)." As reflected in our Congressional mandate, the Commission takes a broad view of "national security" in making this assessment. We have attempted to evaluate how the U.S. relationship with China affects the economic health of our nation, our industrial base, the military and weapons proliferation dangers we face, and our political standing and influence in Asia. Taken together, these elements paint a full picture of how the relationship impacts our broader national security interests.

Based on our analyses to date, as documented in detail in our Report, the Commission believes that a number of the current trends in U.S.-China relations have negative implications for our long-term economic and national security interests, and therefore that U.S. policies in these areas are in need of urgent attention and course corrections.

Nonetheless, the Commission believes that the time is ripe for putting the U.S.-China relationship on a more solid, sustainable footing from the perspective of long-term U.S. interests. The U.S.-China relationship is still in the relatively early stages of its development and is marked by a fluid rather than static environment. The United States has played – and continues to play – an enormous role in the economic and technological development of China. As the Commission has documented through our hearings and reports, U.S. trade, investment, and technology flows have been a critical factor in China's rise as an economic power. We need to use our substantial leverage to develop an architecture that will help avoid conflict, attempt to build cooperative practices and institutions, and advance both countries' long-term interests. The United States has the leverage now and perhaps for the next decade, but this may not always be the case. We also must recognize the impact of these trends directly on the domestic U.S. economy, and develop and adopt policies that ensure that our actions do not undermine our economic interests.

When the Congress approved Permanent Normal Trade Relations (PNTR) for China, the guiding premise was that it would expand market access for U.S. goods and services and, more fundamentally, would lead to economic reform in China and, eventually, political reform. In this context, it was characterized as in our "national security interest" to support China's accession to the WTO. Having taken this significant step, the United States cannot lose sight of these important goals, and must configure its policies toward China to help make them materialize – from expanded trade opportunities for U.S. exporters and a mutually beneficial trade relationship that sets global standards for fair trade, to an open, more democratic society in China that can be

an important partner in addressing regional and global security challenges, including weapons proliferation, terrorism, and peaceful resolution of the cross-Strait situation.

The Commission examined in depth the extent of ongoing cooperation between China and the United States on traditional national security matters, most particularly China's assistance in resolving the North Korea nuclear weapons crisis. The Commission believes that China's performance in this area to date has been unsatisfactory, and we are concerned that U.S. pressure on trade disputes and other unrelated aspects of the relationship may have been toned down by the administration as a concession for China's hoped-for cooperation on this and other vital security matters. The Commission believes that any real progress with China on both the trade and security fronts will require the use of substantial and continuing leverage on the part of the United States.

If we falter in the use of our economic and political influence now to effect positive change in China, we will have squandered an historic opportunity. We believe China demonstrated a willingness to move in a positive direction, and to take substantial risks to do so, when it entered the WTO. But China will likely not initiate the decisive measures toward more meaningful economic and political reform without substantial, sustained, and increased pressure from the United States. And while the United States must pursue its own interests, it is vital for other nations to join our efforts if we are to succeed. Our recommendations to Congress in this Report provide our assessment of particular tools the United States can use to exercise its leverage.

Key Findings and Recommendations

The Report presents its key findings, analysis, and recommendations to Congress in nine chapters, organized in three sections capturing the major themes of our Congressional mandate. While our analysis has been divided in this manner, all of these areas interrelate in assessing the broader question of how the U.S.-China economic relationship affects U.S. economic and national security interests. We recognize that the United States' vast economic transfers to China are inseparable from the larger geopolitical and military developments at issue.

We include within this Executive Summary our priority recommendations to Congress. A full list of the Report's recommendations, by chapter, follows in a separate section.

U.S.-China Trade and Economic Transfers

Bilateral trade and investment flows between the United States and China are taking place on a massive and rapidly increasing scale. Assessing how these flows are affecting the U.S. economy – and with that U.S. economic security – is an essential area of the Commission's work.

Litmus Test for Global Trade Relations

The development of the U.S.-China economic relationship has broader implications for the path of globalization writ large. As generally understood, globalization refers to the process of creating a unified global economy through the breaking down of barriers between national economies. It encompasses the increased integration of national goods, financial, and labor markets. In goods markets, globalization takes the form of increased goods and services trade between countries and the internationalization of production through global supply chains. In labor markets, it manifests itself through increased labor migration and movement of production to labor markets

that are the most cost-effective in terms of wages and working conditions, whether or not they are the result of artificial conditions. In financial markets, it shows up in the international diversification of investor portfolios and increases in cross-border financial flows.

The Commission believes that the U.S.–China economic relationship is of such large dimensions that the future trends of globalization will be influenced to a substantial degree by how the United States manages its economic relations with China. It is reasonable to believe that U.S.-China economic relations will help shape the rules of the road for broader global trade relations. If current failings are remedied and the relationship is developed so as to provide broad-based benefits for both sides, globalization will likely be affected in a positive manner on a worldwide scale. If not, the opposite will likely be true.

Further, the Commission recognizes that many of the challenges facing the U.S. economy from globalization require changes in U.S. policy that go well beyond specific responses to China's practices. Improving U.S. economic competitiveness and the welfare of U.S. workers will require actions including enhanced national commitments to education, infrastructure modernization, changes in U.S. tax policy to encourage U.S.-based production and research and development (R&D), and to more comprehensive retraining programs for U.S. workers negatively impacted by trade. However, given our mandate, we have focused our recommendations to Congress on items tailored to meet the more specific economic challenges of China.

The Imbalanced U.S.-China Trade Relationship and the Consequences for the U.S. Economy

The dominant feature of U.S.-China economic relations is the U.S. goods trade deficit, which rose by more than twenty percent in 2003 to a record $124 billion. This deficit now constitutes over twenty-three percent of the total U.S. goods trade deficit, and China is by far the largest country component of the deficit. Moreover, U.S. trade with China – with $28 billion in exports to China as compared with $152 billion in imports in 2003 – is by far the United States' most lopsided trade relationship as measured by the ratio of imports to exports. China is heavily dependent on the U.S. market, with exports to the United States constituting 35 percent of total Chinese exports in 2003.

A key factor contributing to the U.S. deficit with China is the undervaluation of the Chinese yuan against the U.S. dollar. This gives Chinese manufacturers a competitive advantage over U.S. manufacturers. Economic fundamentals suggest that the Chinese yuan is undervalued, with a growing consensus of economists estimating the level of undervaluation to be anywhere from fifteen to forty percent. The Chinese government persistently intervenes in the foreign exchange market to keep its exchange rate pegged at 8.28 yuan per dollar, and through these actions appears to be manipulating its currency valuation. A second factor contributing to imbalances in U.S.-China trade is China's mercantilist industrial and foreign direct investment policies. These policies involve a wide range of measures including technology transfer requirements, government subsidies, discriminatory tax relief, and limitations on market access for foreign companies. Finally, China's labor markets do not provide adequate recognition of workers' rights, thereby resulting in artificially low wages that disadvantage our economic interests.

The U.S. trade deficit with China is of major concern because (i) it has contributed to the erosion of manufacturing jobs and jobless recovery in the United States, (ii) manufacturing is critical for the nation's economic and national security, and (iii) the deficit has adversely impacted other sectors of the U.S. economy as well. Therefore, our trade and investment relationship with China

– with current trends continuing and the deficit expanding – is not just a trade issue for the United States, but a matter of our long-term economic health and national security.

Recommendation: In the absence of concrete progress by the administration in moving China toward an substantial upward revaluation of the yuan against the dollar and to repegging the yuan to a trade-weighted basket of currencies, Congress should pursue legislative measures that will direct the administration to take action – through the WTO or otherwise – to combat China's exchange rate practices. The administration should concurrently encourage our trading partners with similar interests to join in this effort.

Recommendation: Congress should direct the United States Trade Representative (USTR) and the Department of Commerce to undertake immediately a comprehensive investigation of China's system of government subsidies for manufacturing, including tax incentives, preferential access to credit and capital from state-owned financial institutions, subsidized utilities, and investment conditions requiring technology transfers. The investigation should also examine discriminatory consumption credits that shift demand toward Chinese goods, Chinese state-owned banks' practice of noncommercial-based policy lending to state-owned and other enterprises, and China's dual pricing system for coal and other energy sources. USTR and Commerce should provide the results of this investigation in a report to Congress that assesses whether any of these practices may be actionable subsidies under the WTO and lays out specific steps the U.S. government can take to address these practices.

China's Mixed Record in the WTO

China joined the WTO in December 2001. Its accession agreement is extremely complex, reflecting the need for special arrangements to address the fact that China does not have a market-based economy. To protect against trade distortions and unfair trade practices resulting from China's non-market status, the agreement includes a special WTO review mechanism – the Transitional Review Mechanism (TRM) – to monitor China's compliance and special safeguard provisions giving WTO members the right to protect themselves against sudden surges of Chinese imports.

Though China has made progress in reducing tariffs and otherwise formally meeting a large number of its WTO accession commitments, significant compliance shortfalls persist in a number of key areas for U.S. trade. Among areas of concern are China's manipulation of its currency, continued provision of direct and indirect subsidies to Chinese producers, use of unjustified technical and safety standards to exclude foreign products, poor enforcement of intellectual property rights (IPR), and discriminatory tax treatment for domestic semiconductor production. Moreover, China has deliberately frustrated the effectiveness and debased the value of the WTO's TRM, which was intended to be a robust mechanism for assessing China's WTO compliance and for placing multilateral pressure on China to address compliance shortfalls.

Recommendation: Congress should press the administration to make more use of the WTO dispute settlement mechanism and/or U.S. trade laws to redress unfair Chinese trade practices. In particular, the administration should act promptly to address China's exchange rate manipulation, denial of trading and distribution rights, lack of IPR protection, objectionable labor standards, and subsidies to export industries. On IPR, the United States must take action to force China to enact credible criminal penalties for IPR violations and to greatly enhance enforcement. Another key priority for U.S. trade officials must be ensuring China's compliance with its WTO commitments to refrain from forced technology transfers

used as a condition of doing business. In pursuing these cases, Congress should encourage USTR to consult with trading partners who have mutual interests at the outset of each new trade dispute with China.

Recommendation: Congress should press the administration to make better use of the China-specific section 421 and textile safeguards negotiated as part of China's WTO accession agreement to give relief to U.S. industries especially hard hit by surges in imports from China.

Recommendation: Congress should encourage USTR and other appropriate U.S. government officials to take action to ensure that the WTO's Transitional Review Mechanism process is a meaningful multilateral review that measures China's compliance with its WTO commitments. If China continues to frustrate the TRM process, the U.S. government should work with the European Union, Japan, and other major trading partners to produce a separate, unified annual report that measures and reports on China's progress toward compliance and coordinates a plan of action to address shortcomings.

Governance and Security Concerns with China's Outreach to the Global Capital Markets

The Chinese government has selectively chosen firms – predominately state-owned enterprises (SOEs) – to list on international capital markets, primarily in Hong Kong and New York, and may bring as much as $23 billion in initial public offerings to global capital markets in 2004, a marked increase over the past few years. Yet, Chinese corporate governance standards lag far behind those in the United States. Accounting and reporting standards are weak, and China lacks a sound, transparent system of credit ratings. As a result, even the most sophisticated investors lack adequate disclosure when it comes to Chinese debt and equity listings in international capital markets.

Moreover, inadequate transparency and disclosure prevents the U.S. government and investors from understanding the possible nexus between Chinese firms listing on U.S. and international capital markets and weapons proliferation and/or China's defense-industrial complex. Many SOEs were previously controlled by the People's Liberation Army (PLA), and there is concern that unofficial links to the PLA remain intact after privatization. At least one firm listed in China's capital markets and available for purchase by qualified U.S. investors – China North Industries Corp. – has been sanctioned for proliferation by the U.S. government, and there are concerns that other Chinese firms listed or trading in China or in the United States may be engaging in similar activities.

Without adequate information about Chinese firms trading in international capital markets, U.S. investors may be unwittingly pouring money into black box firms lacking basic corporate governance structures, as well as enterprises involved in activities harmful to U.S. security interests.

Recommendation: Congress should reinstate the reporting provision of the 2003 Intelligence Authorization Act [P.L. 107-306, Sec 827] directing the director of Central Intelligence (DCI) to prepare an annual report identifying Chinese or other foreign companies determined to be engaged or involved in the proliferation of weapons of mass destruction or their delivery systems that have raised, or attempted to raise, funds in the U.S. capital markets. In addition, Congress should expand this provision to require the DCI to include a broader interagency review of the security-related concerns of Chinese firms accessing, or seeking to access, the

U.S. capital markets that would examine linkages between proliferation and other security-related concerns and Chinese companies, including their parents and subsidiaries, with a presence in the U.S. capital markets.

Recommendation: Congress should bar U.S. institutional or private investors from making debt or equity investments, directly or indirectly, in firms identified and sanctioned by the U.S. government for weapons proliferation-related activities, whether they are listed and traded in the United States or in the Chinese or other international capital markets.

We note that these bilateral trade and investment dynamics are occurring at a time of significant economic stresses in China, with growing numbers of economists and financial analysts cautioning about the possible bursting of the bubble in China's economy. These predictions rest on concerns about the economy overheating and on concerns about the weak foundation of the Chinese banking system, which has accumulated nonperforming loans estimated to be $500 billion after decades of making loan decisions based on policy or political grounds rather than financial considerations.

These suspect capital allocation practices raise cautionary flags about the sustainability of China's economic boom. It is crucial that U.S. policymakers understand the potential ramifications for the U.S. economy and investors, China's Asian trading partners, and China's domestic stability should China's economic bubble burst.

Regional and Geostrategic Developments

The Commission examined China's rise as a regional power and its central role in the global security challenges stemming from the proliferation of weapons of mass destruction (WMD) and access to energy supplies. In this examination, we weighed the extent to which China is contributing to or undermining a more stable global security environment.

China's Regional Diplomatic Offensive

Through trade and investment, China has become increasingly interconnected with its Asian neighbors. Investors from Hong Kong, Taiwan, Japan, South Korea and Southeast Asia are helping to fuel the export processing industries of China that deliver a wide array of manufactured goods to the United States and Europe through global supply chains. China's industrial growth has attracted foreign direct investment that might otherwise have gone elsewhere; some industries in Northeast and Southeast Asia have been displaced by competition from China; but Asian suppliers also have been increasingly feeding China's export processing industries and domestic markets. Large trade surpluses with China in 2002-03 contributed to the growth of most regional economies.

Enhanced regional economic linkages have served China's political agenda. Through increasingly active and sophisticated bilateral and multilateral diplomacy, China is presenting itself as a country that is peacefully rising, offering win-win solutions for its economic partners in Asia. It has shown a greater willingness in recent years to participate actively in multilateral forums on both economic and security issues – such as APEC, the ASEAN Regional Forum, and the Shanghai Cooperation Organization. Evidence indicates that this diplomatic strategy is making inroads for China, despite a wariness of China's growing military power, particularly on the part of Japan.

While China has undertaken a diplomatic offensive in Asia to reassure its neighbors of its long-term peaceful intentions, buying time and space in the process to pursue its economic development and military strengthening, countries in the region appear to perceive the United States as losing focus on Asia as it prosecutes the war on terrorism. The Commission believes that the United States' influence and vital long-term interests in Asia are being challenged by China's robust regional economic engagement and diplomacy, and that greater attention must be paid to U.S. relations in the region.

Recommendation: Congress should revitalize U.S. engagement with China's Asian neighbors by encouraging U.S. diplomatic efforts to identify and pursue initiatives to demonstrate the United States' firm commitment to facilitating the economic and security needs of the region. These initiatives should have a regional focus and complement bilateral efforts. The Asia-Pacific Economic Cooperation forum (APEC) offers a ready mechanism for pursuit of such initiatives.

Growing Tensions Across the Strait and in Hong Kong

China has not offered win-win political solutions to Taiwan and Hong Kong. China has been building missile forces and positioning its military to deter Taiwan from taking political steps Beijing considers unacceptable moves towards independence and to coerce Taiwan to end the island's continued separate status. Further, China is using its political clout to keep Taiwan out of regional and bilateral economic arrangements and to otherwise economically marginalize the island. Taiwan President Chen Shui-bian's recent reelection and Chen's plan for constitutional revision have heightened China's anxiety regarding Taiwan and heightened the near-term prospects for conflict. In Hong Kong, China's National People's Congress has undercut Hong Kong's autonomy and self-governance by its recent unilateral decisions to rule out near-term direct elections for Hong Kong's chief executive and Legislative Council. Moreover, Beijing has engaged in a systemic campaign in recent weeks to intimidate the democracy movement in Hong Kong by depicting its leaders as unpatriotic toward China, directing an unprecedented visit of eight Chinese warships to Hong Kong's harbor, and prohibiting legislative debate on electoral matters in Hong Kong's legislature.

China's recent actions toward Taiwan and Hong Kong call into question its commitments to a peaceful approach toward Taiwan and to preserving Hong Kong's autonomy and self-government. These developments merit a fresh look at U.S. policies in these areas by the Congress and executive branch. In particular, recent developments across the Strait are putting increasing stress on the United States' one China policy, demonstrating the need for a new assessment of this policy that takes into consideration current realities.

Recommendation: Congress should consult with the administration to assess jointly whether the PRC's recent interventions impacting Hong Kong's autonomy constitute grounds for invoking the terms of the U.S.-Hong Kong Policy Act with regard to Hong Kong's separate treatment. This includes U.S. bilateral relations with Hong Kong in areas such as air services, customs treatment, immigration quotas, visa issuance, and export controls. In this context, Congress should assess the implications of the National People's Congress Standing Committee's intrusive interventions with regard to matters of universal suffrage and direct elections. Congress and the administration should continue to keep Hong Kong issues on the U.S.-PRC bilateral agenda and work closely with the United Kingdom on Hong Kong issues.

Recommendation: Congress should enhance its oversight role in the implementation of the Taiwan Relations Act. Executive branch officials should be invited to consult on intentions and report on actions taken to implement the TRA through the regular committee hearing process of the Congress, thereby allowing for appropriate public debate on these important matters. In this same context, Congress and the administration should conduct a fresh assessment of the one China policy, given the changing realities in China and Taiwan. This should include a review of:

- The policy's successes, failures, and continued viability;
- Whether changes may be needed in the way the United States government coordinates its defense assistance to Taiwan, including the need for an enhanced operating relationship between U.S. and Taiwan defense officials and the establishment of a U.S.-Taiwan hotline for dealing with crisis situations.
- How U.S. policy can better support Taiwan's breaking out of the international economic isolation that the PRC seeks to impose on it and whether this issue should be higher on the agenda in U.S.-China relations. Economic and trade policy measures that could help ameliorate Taiwan's marginalization in the Asian regional economy should also be reviewed. These could include enhanced U.S.-Taiwan bilateral trade arrangements that would include protections for labor rights, the environment, and other important U.S. interests.

Recommendation: Congress should consult with the administration on developing appropriate ways for the United States to facilitate actively cross-Strait dialogue that could promote the long-term, peaceful resolution of differences between the two sides and could lead to direct trade and transport links and/or other cross-Strait confidence-building measures. The administration should be directed to report to Congress on the status of cross-Strait dialogue, the current obstacles to such dialogue, and, if appropriate, efforts that the United States could undertake to promote such a dialogue.

China's Intermediary Role in the Standoff with North Korea

China has become a major diplomatic player in the ongoing standoff with North Korea over Pyongyang's development of nuclear weapons. As host of the Six Party Talks, China has helped bring North Korea to the table; but has not adequately employed its considerable political and economic leverage over North Korea to drive Pyongyang towards acceptance of the goal of achieving a complete, verifiable, and irreversible dismantlement of North Korea's nuclear weapons programs. Even as events in North Korea unfold, Chinese state companies continue to pursue deals to sell WMD-related items to countries of concern to the United States. The United States has repeatedly imposed sanctions in response to these activities; but sanctions remain limited to penalizing offending companies, despite many of these companies' direct affiliation with top levels of the PRC government or military.

The United States has placed great faith in China's ability to move North Korea toward renouncing its nuclear weapons programs. The U.S.-China working relationship to defuse this crisis has been lauded as an essential component in bilateral relations, one that appears to trump other areas of U.S. concern. The Commission believes China has not effectively utilized its substantial leverage over North Korea to produce a workable resolution and regards China's performance in this regard over the next few months as a key test of the U.S.-China relationship.

Recommendation: Should the current stalemate in the Six Party Talks continue, Congress should press the administration to work with its regional partners, intensify its diplomacy, and ascertain North Korean and Chinese intentions with a detailed and staged proposal beginning with a freeze of all North Korea's nuclear weapons programs, followed by a verifiable and irreversible dismantlement of those programs. Further work in this respect needs to be done to determine whether a true consensus on goals and process can be achieved with China. If this fails, the United States must confer with its regional partners to develop new options to resolve expeditiously the standoff with North Korea, particularly in light of public assessments that the likely Korean uranium enrichment program might reach a stage of producing weapons by 2007.

Recommendation: Congress should press the administration to renew efforts to secure China's agreement to curtail North Korea's commercial export of ballistic missiles and to encourage China to provide alternative economic incentives for the North Koreans to substitute for the foreign exchange that would be foregone as a result of that curtailment.

China's Energy Trajectory and the Implications for Global Energy Markets

China has moved past Japan to rank second behind the United States in global energy consumption, and is the world's second largest oil consumer and its third largest oil importer. These trends have made China increasingly dependent on imported energy sources. China has pursued its energy security strategy via bilateral energy deals, and does not maintain a meaningful strategic petroleum reserve or participate in multilateral energy market stabilizing arrangements. China's rising energy demand has put added pressure on global petroleum supplies and prices. Indeed, the recent escalation in gasoline prices in the United States has been attributed, in part, to the impact of China's growing pressure on world oil supplies and the absence of any mechanism in place to counter this pressure and maintain stable prices for consumers. It also has had consequences for China's economy, as energy shortages and blackouts have led to slowdowns in industrial production in certain sectors.

Energy needs have driven China closer to the Middle East and Africa, as well as neighbors in Central Asia, Russia and the Pacific. China seeks to lock in secure energy supplies, especially new sources of gas and oil not subject to potential disruption in a time of conflict. China has sought energy cooperation with countries of concern to the United States, including Iran and Sudan, which are inaccessible by U.S. and other western firms. Some analysts have voiced suspicions that China may have offered WMD-related transfers as a component of some of its energy deals.

China's growing energy needs, linked to its rapidly expanding economy, are creating economic and security concerns for the United States. China's energy security policies are driving it into bilateral arrangements that undermine multilateral efforts to stabilize oil supplies and prices, and in some cases may involve dangerous weapons transfers.

Recommendation: Congress should direct the secretaries of State and Energy to consult with the International Energy Agency with the objective of upgrading the current loose experience-sharing arrangement, whereby China engages in some limited exchanges with the organization, to a more structured arrangement whereby the PRC would be obligated to develop a meaningful strategic reserve, and coordinate release of stocks in supply disruption crises or speculator-driven price spikes.

Technology and Military Advancements

China has undergone rapid advancements in technology development, military modernization, and media control. These advancements are altering bilateral and regional trade flows, the cross-Strait military balance, and the Chinese government's ability to control the media and shape perceptions of the United States and its policies.

China's Coordinated National Strategy for Technology Development

The Chinese government has developed and pursued a coordinated strategy for attracting and directing national and foreign investment into high-tech research, development, and production. This strategy for high-tech investment has been a sustained, multi-year effort that has paid dividends for economic growth, science and technology institutions, educational infrastructure, technical levels of workers and industries, and military modernization. The United States and other foreign partners – both commercial and governmental – have contributed significantly to these developments. U.S. advanced technology and technological expertise is transferred to China in a number of ways, both legal and illegal, including through U.S. invested firms and research centers in China, Chinese investments in the United States, bilateral science and technology (S&T) cooperative programs, and Chinese students and researchers who return home following their work and study at U.S. universities and research institutes.

China's development as a locus of high-technology manufacturing and R&D has been a key component of its economic reform strategy, and the pace of this development has exceeded many outside observers' expectations. What China does with its growing technology capabilities – whether it converts them to military uses and/or to control the free flow of information to its population – is of direct national security concern to the United States. Moreover, the extent to which these advances allow China to challenge U.S. competitiveness in technology development is a vital matter for U.S. economic security.

The U.S. government collects inadequate data on the shifts of U.S. high-tech investment, technology transfers, and R&D to China. Information on U.S. transfers of technology subject to export licensing is compiled and government reporting on official S&T cooperation efforts has improved somewhat under Congressional mandate; but the overall picture of U.S. contributions to the development of China's technology growth and R&D base is not at all clear. Assessments of the implications of these shifts for the United States' long-term technological superiority and for China's competitiveness – both commercially and militarily – are difficult to make as a result of this gap in knowledge. Moreover, the process by which the U.S. government reviews acquisitions of American companies by Chinese and other foreign investors – the Committee on Foreign Investment in the United States (CFIUS) – focuses solely on traditional national security concerns with such investments, while failing to consider broader U.S. economic security interests.

Recommendation: Congress should direct the administration to develop and publish a coordinated, comprehensive national policy and strategy designed to meet China's challenge to the maintenance of our scientific and technological leadership and competitiveness in the same way it is presently required to develop and publish a national security strategy.

Recommendation: Congress should revise the law governing the CFIUS process to expand the definition of national security to include the potential impact on national economic security

as a criterion to be reviewed, and should direct the administration to transfer chairmanship of CFIUS from the Secretary of the Treasury to the Secretary of Commerce.

Military Modernization and the Shift in the Cross-Strait Military Balance

Commission research and hearings indicate that China's military capabilities increasingly appear to be shaped to fit a Taiwan conflict scenario and to target U.S. air and naval forces that could become involved. China's modern arsenal includes an increasingly sophisticated nuclear missile force that is of direct strategic concern to the United States, while in the Western Pacific theater China has deployed over five hundred conventional short-range ballistic missiles that threaten Taiwan and longer-range conventional missiles that could threaten Japan and U.S. forces deployed in the region. China's advanced naval and air weapons systems – including surface ships, submarines, anti-ship missiles, and advanced fighter aircraft – have been significantly enhanced by infusions of foreign military technology, co-production assistance and direct purchases, mainly from Russia and, to a lesser extent, from Israel.

China's quantitative and qualitative military advancements have resulted in a dramatic shift in the cross-Strait military balance toward China, with serious implications for Taiwan, for the United States, and for cross-Strait relations.

Recommendation: Congress should urge the President and the secretaries of State and Defense to press strongly their European Union counterparts to maintain the EU arms embargo on China.

Recommendation: Congress should direct the administration to restrict foreign defense contractors who sell sensitive military-use technology or weapons systems to China from participating in U.S. defense-related cooperative research, development, and production programs, which restriction can be targeted to cover only those technology areas involved in the transfer to China, and to provide a comprehensive annual report to the appropriate committees of Congress on the nature and scope of foreign military sales to China, particularly from Russia and Israel.

Continued Controls Over The Media

The Chinese government continues to exercise strong controls on the dissemination of information via the public media. While there has been some loosening of controls on reporting of news relating to many areas of business and society in China, red lines remain that are dangerous for individuals or organizations to exceed.

The Chinese government's propaganda machinery has not withered away during twenty-five years of reform and opening; rather it has modernized. This was proven beyond doubt during the SARS epidemic of 2003. The Chinese government's intensive efforts to cover up the outbreak of SARS showed the breadth of the government's control, while the ability of many in the population to nonetheless access information about the epidemic via the Internet, text messaging, and other new media demonstrated the limitations of this control in a growing high-tech society.

Government censorship; jamming of some overseas broadcasts, including those of U.S. government-sponsored outlets like the Voice of America; blocking of foreign and domestic Internet Web sites; and punishments for those who disseminate information beyond the government's tolerance remain widespread. Open criticism of China's leaders, questioning of the

Communist Party and its policies, organizational activities that are independent of government control, and anything perceived as conducive to political conduct remains taboo in the public media. The Chinese government has used its control over the media to shape the population's perceptions of the United States and its policies, leading to a consistent message in the Chinese media that has been particularly critical of U.S. foreign policy and intentions in Asia.

Despite the Chinese government's much heralded reversal of policy to encourage more open and accurate reporting of SARS during last year's outbreak, there has in practice been no fundamental change in the Chinese government's approach to controlling the media, including information available through the Internet. This control shapes the Chinese population's perceptions of the United States and its policies, enhancing the risk of misperception and miscalculation in the bilateral relationship and increasing the potential for, and the difficulty of, managing crisis situations.

Recommendation: Congress should enhance funding for the Broadcasting Board of Governors' programs aimed at circumventing China's Internet firewall through the development of anticensorship technologies and methods, and direct the Department of Commerce and other relevant agencies to conduct a review of export administration regulations to determine whether restrictions are needed on the export of U.S. equipment, software, and technologies that permit the Chinese government to surveil its own people or censor free speech.

Conclusion

It is now commonplace to assert that the U.S.-China relationship will be our most significant bilateral relationship during the Twenty-First Century. Our trade and investment with China already has an enormous impact on the U.S. economy, and the security challenges before us are of the highest order. Through an appropriate mix of U.S. policies, this complex relationship can be managed in such a way as to minimize the downside risks, and enhance the prospects of moving China toward a more open, democratic and market-oriented society, to the benefit of both our economic and national security interests.

As we stated at the outset, we have concluded that a number of the current trends in U.S.-China relations are presently moving in the wrong direction. With a renewed and realistic focus on the relationship by the Congress, we are optimistic that U.S. policy toward China can be put on a more solid, productive footing to tackle the long-term challenges that lie ahead.

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Memorandum August 31, 1998

TO : Rep. Curt Weldon
House Select Committee on U.S. National Security and Military/Commercial Concerns with the People's Republic of China

FROM : Shirley A. Kan (ext. 7-7606)
Specialist in National Security Policy
Foreign Affairs and National Defense Division

SUBJECT : Chronology of Chinese Weapon-related Transfers

In response to your request at my briefing on Loral for the House Select Committee on China on August 17, 1998, I am forwarding this updated memo which provides a chronology of instances or periods of reported sensitive weapon-related transfers by China. The table also shows the international regime and U.S. laws that call for controls on such transfers and the Administration's response (since the beginning of the Clinton Administration in 1993). The memo was originally prepared in September 1997 for the House National Security Committee and was updated for you in May. The following transfers were alleged by news media and/or reported by the Administration, including unclassified reports by the Director of Central Intelligence (DCI). Some transfers were confirmed by the Administration. Attempted sales as reported in the media were excluded. Specific sources can be produced on request. For details, see attached CRS Issue Brief 92056, *Chinese Proliferation of Weapons of Mass Destruction. Current Policy Issues.*

A separate memo on reported Russian transfers is being updated by Robert Shuey. If you have further questions, please call at 7-7606.

Abbreviations Used for International Regimes to Which China Committed

BWC Biological Weapons Convention
CWC Chemical Weapons Convention
MTCR Missile Technology Control Regime (China not an adherent but pledged to abide)
NPT Nuclear Nonproliferation Treaty

Date of Reported Transfer or Report	Reported Transfer by China	Possible Violation	Administration's Response
Nov. 1992	M-11 missile-related equipment to Pakistan	MTCR Arms Export Control Act Export Administration Act	sanctions imposed on Aug. 24, 1993, for transfers of M-11 related equipment (not missiles); waived on Nov. 1, 1994
Nov. 1992	34 M-11 short-range ballistic missiles (stored in crates at Sargodha Air Force Base in Pakistan)	MTCR Arms Export Control Act Export Administration Act	no reported sanctions
Mid-1994 to mid-1995	dozens or hundreds of missile guidance systems and computerized machine tools to Iran	MTCR Iran-Iraq Arms Nonproliferation Act Arms Export Control Act Export Administration Act	no reported sanctions
2nd quarter of 1995	parts for the M-11 missile to Pakistan	MTCR Arms Export Control Act Export Administration Act	no reported sanctions
Dec. 1994 to mid-1995	5,000 ring magnets for an unsafeguarded nuclear enrichment program in Pakistan	NPT Export-Import Bank Act Nuclear Proliferation Prevention Act Arms Export Control Act	considered sanctions under the Export-Import Bank Act; but announced on May 10, 1996, that no sanctions would be imposed
Sept. 1995	calutron (electromagnetic isotope separation system) for uranium enrichment to Iran	NPT Nuclear Proliferation Prevention Act Export-Import Bank Act Arms Export Control Act	no reported sanctions

1995-1997	C-801 and C-802 anti-ship cruise missiles to Iran	Iran-Iraq Arms Nonproliferation Act	no reported sanctions
before Feb. 1996	dual-use chemical precursors and equipment to Iran's chemical weapon program	Arms Export Control Act Export Administration Act	sanctions imposed on May 21, 1997, under the Arms Export Control Act and Export Administration Act[1]
summer 1996	400 tons of chemicals to Iran	Iran-Iraq Arms Nonproliferation Act Arms Export Control Act Export Administration Act	no reported sanctions
Aug. 1996	plant to manufacture M-11 missiles or missile components in Pakistan	MTCR Arms Export Control Act Export Administration Act	no reported sanctions
Aug. 1996	gyroscopes, accelerometers, and test equipment for missile guidance to Iran	MTCR Iran-Iraq Arms Nonproliferation Act Arms Export Control Act Export Administration Act	no reported sanctions
Sept. 1996	special industrial furnace and high-tech diagnostic equipment to unsafeguarded nuclear facilities in Pakistan	NPT Nuclear Proliferation Prevention Act Export-Import Bank Act Arms Export Control Act	no reported sanctions
July-Dec. 1996	DCI reported "tremendous variety" of technology and assistance for Pakistan's ballistic missile program	MTCR Arms Export Control Act Export Administration Act	no reported sanctions

[1] Sanctions were not imposed under the IranIraq Arms Nonproliferation Act, apparently because provisions on chemical, biological, or nuclear weapons were not enacted until February 10, 1996.

July-Dec. 1996	DCI reported "tremendous variety" of assistance for Iran's ballistic missile program	MTCR Iran-Iraq Arms Nonproliferation Act Arms Export Control Act Export Administration Act	no reported sanctions
July-Dec. 1996	DCI reported "principal" supplies of nuclear equipment, material, and technology for Pakistan's nuclear weapon program	NPT Nuclear Proliferation Prevention Act Export-Import Bank Act Arms Export Administration Act	no reported sanctions
July-Dec. 1996	DCI reported key supplies of technology for large nuclear projects in Iran	NPT Iran-Iraq Arms Nonproliferation Act Nuclear Proliferation Prevention Act Export-Import Bank Act Arms Export Administration Act	no reported sanctions
July-Dec. 1996	DCI reported "considerable" chemical weapon-related transfers of production equipment and technology to Iran	Iran-Iraq Arms Nonproliferation Act Arms Export Control Act Export Administration Act	no reported sanctions
Jan. 1997	dual-use biological items to Iran	BWC Iran-Iraq Arms Nonproliferation Act Arms Export Control Act Export Administration Act	no reported sanctions
June 1997	chemical precursors, production equipment, and production technology for Iran's chemical weapon program, including a plant for making glass-lined equipment	Iran-Iraq Arms Nonproliferation Act Arms Export Control Act Export Administration Act CWC	no reported sanctions

Sept. to Dec. 1997	China Great Wall Industry Corp. provided telemetry equipment used in flight-tests to Iran for its development of the Shahab-3 and Shahab-4 medium range ballistic missiles	MTCR Iran-Iraq Arms Nonproliferation Act Arms Export Control Act Export Administration Act	no reported sanctions
1997	DCI reported transfers of missile-related technology to Pakistan	MTCR Arms Export Control Act Export Administration Act	no reported sanctions
1997	DCI reported transfers of missile-related goods and technology to Iran's medium-range ballistic missile program	MTCR Arms Export Control Act Export Administration Act Iran-Iraq Arms Nonproliferation Act	no reported sanctions
1997	DCI reported "primary" supplies of chemical weapon-related material to Iran	Iran-Iraq Arms Nonproliferation Act Arms Export Control Act Export Administration Act CWC	no reported sanctions

Memorandum

Date: April 22, 2004

TO: Representative Curt Weldon
Attention: Greg Calhoun

FROM: Shirley A. Kan (ext. 7-7606), Coordinator
Specialist in National Security Policy

Sharon Squassoni
Specialist in National Defense

Foreign Affairs, Defense, and Trade Division

SUBJECT: Reported Cases of Weapons Proliferation by Entities in China and Russia

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This memorandum responds to your request for updated information on technology transfers since 1998 by entities in the People's Republic of China (PRC) and Russia related to the proliferation of weapons of mass destruction (WMD) and missiles. Transfers related to conventional weapons are not covered. The two tables in this memo summarize cases of such transfers by PRC and Russian entities that the press or the Administration have reported publicly. CRS has no independent confirmation of those reported cases. The tables are not intended as exhaustive lists of the transfers that have taken place, since there are probably transfers with classified information known to the intelligence community but not publicly reported. The Director of Central Intelligence (DCI) has provided reports to Congress (originally required as semi-annual reports, now required as annual reports) under Section 721 of the FY 1997 Intelligence Authorization Act, P.L. 104-293, entitled "Unclassified Report to Congress on the Acquisition of Technology Relating to Weapons of Mass Destruction and Advanced Conventional Munitions." These unclassified reports have named China, Russia, and North Korea as "key suppliers" of sensitive technology, but have not provided details about their transfers. Moreover, Administrations have not provided full public justifications when imposing sanctions on named PRC or Russian entities, and have imposed sanctions in numerous cases without naming the targets of sanctions, which might or might not have included PRC or Russian entities in those cases. The State Department publishes announcements on sanctions in the *Federal Register*. There might also be other applicable laws, treaties, or multilateral control regimes not specifically named in the tables,

such as laws targeting sponsors of terrorism. On U.S. sanctions in general, see enclosed CRS Report RL31502, *Nuclear, Biological, Chemical, and Missile Proliferation Sanctions: Selected Current Law*, by Dianne Rennack. On international nonproliferation regimes, see CRS Report RL31559, *Proliferation Control Regimes: Background and Status*, by Sharon Squassoni, Steven Bowman, and Carl Behrens.

Abbreviations

SRBM	Short-range ballistic missile
MRBM	Medium-range ballistic missile
AG	Australia Group (on chemical and biological weapons)
MTCR	Missile Technology Control Regime
NPT	Nuclear Nonproliferation Treaty
AECA	Arms Export Control Act
EAA	Export Administration Act of 1979
EIBA	Export-Import Bank Act of 1945
FAA	Foreign Assistance Act of 1961
IIANA	Iraq-Iran Arms Nonproliferation Act of 1992
INA	Iran Nonproliferation Act of 2000
NPPA	Nuclear Proliferation Prevention Act of 1994

China[1]

The table below on PRC transfers draws from the enclosed CRS Report RL31555, *China: Proliferation of Weapons of Mass Destruction and Missiles: Policy Issues*, by Shirley Kan. The United States and the PRC have bilateral agreements related to weapons nonproliferation, in addition to applicable laws, treaties, and regimes. Also see the table at the end of that CRS Report that summarized the PRC entities that have been named as subject to sanctions for weapons proliferation under successive Administrations.

Table 1 - Reported Cases of WMD-Related Technology Transfers by PRC Entities

Date of Reported Transfer or Report	Reported Transfer and Recipient	Possibly Applicable U.S. Law, Treaty, and/or Regime	Administration's Actions on Sanctions
In 1998 or earlier, according to a March 23, 2000 report in *Nucleonics Week (NW)*	China National Nuclear Corporation (CNNC) provided to Pakistan "significant" equipment for a secret heavy water production plant at Khushab, where an unsafeguarded reactor allegedly started up in April 1998 and generated weapons-grade plutonium, according to former U.S. nonproliferation and intelligence officials.	NPT AECA EIBA NPPA	Not publicly known. White House and State Department officials denied to *NW* that China was the supplier but said that they did not know the plant's origins. CNNC is not among publicly named PRC entities subject to U.S. sanctions.

[1] Written by Shirley Kan, Specialist in National Security Policy.

May 24, 1998 report in *London Daily Telegraph*	Sino-Chem Corporation's branch in Tianjin, China, supplied to Iran 500 tons of phosphorus pentasulphide (controlled by the AG for its use in making nerve agents).	AG AECA EAA IIANA	Not publicly known. Sino-Chem is not among publicly named PRC entities subject to sanctions.
In November 1998, according to reports in *Washington Post* on November 13, 1998 and *Washington Times* on December 7, 1998	While visiting Beijing, Acting Undersecretary of State John Holum protested continuing PRC missile technology transfers to Iran, including a shipment of telemetry equipment.	MTCR AECA EAA IIANA	On November 21, 2000, the State Department said it waived sanctions on PRC entities for past assistance to missile programs in Pakistan and Iran, while it imposed sanctions on Pakistani and Iranian entities. It is not publicly confirmed whether this action covered these transfers.
In late 1998, according to a February 23, 1999 report in *Washington Times*	The National Security Agency (NSA) suspected China Academy of Launch Vehicle Technology (CALT) of working with North Korea on its space program to develop satellites (closely related to missiles), but not confirmed to involve the Taepo Dong MRBM.	MTCR AECA EAA	Not publicly known. The State Department previously sanctioned CALT on August 24, 1993.
In 1999, according to an April 15, 1999 report in *Washington Times*	U.S. intelligence was said to suspect continued PRC assistance to Iran, including specialty steel, telemetry equipment, and training on inertial guidance.	MTCR AECA EAA IIANA INA	On November 21, 2000, the State Department said it waived sanctions on PRC entities for past assistance to missile programs in Pakistan and Iran, while it imposed sanctions on Pakistani and Iranian entities. It is not publicly confirmed whether this action covered these transfers.

In 1999, according to an April 15, 1999 report in *Washington Times*	U.S. intelligence reportedly suspected that China Poly Ventures Company delivered, perhaps in 1999, U.S.-made specialized metal-working presses and a special furnace to Pakistan's National Development Center, a missile plant.	MTCR AECA EAA	China Poly Ventures is not among the publicly named PRC entities that have been subject to U.S. sanctions. On November 21, 2000, the State Department said it waived sanctions on PRC entities for past assistance to missile programs in Pakistan and Iran, while it imposed sanctions on Pakistani and Iranian entities. It is not publicly confirmed whether this action covered these transfers.
March 8, 1999 report by the NSA, cited in an April 15, 1999 report in *Washington Times*	Entity or entities in China sold specialty steel for use in North Korea's missile program. The DCI first publicly confirmed PRC supplies to North Korea in July 1999.	MTCR AECA EAA	Not publicly known.
In June 1999, according to a July 20, 1999 report in *Washington Times*	U.S. intelligence reportedly found that entities in China transferred accelerometers, gyroscopes, and precision grinding machinery to North Korea.	MTCR AECA EAA	Not publicly known.
In December 1999, according to a January 1, 2000 report in *Washington Times*	The NSA reportedly discovered that an entity or entities in China supplied PRC-made missile-related items to North Korea through a Hong Kong company.	MTCR AECA EAA	Not publicly known.
In December 1999, according to a January 21, 2000 report in *Washington Times*	PRC entity or entities agreed to build a hypersonic wind tunnel in Libya for designing missiles.	MTCR AECA EAA	Not publicly known.

In March 2000, according to an April 13, 2000 report in *Washington Times*	The NSA was said to report on March 2, 2000, that China Precision Machinery Import Export Corporation (CPMIEC) transferred to Libya technology to develop its Al Fatah SRBM. In August 2000, the DCI first publicly confirmed PRC missile assistance to Libya.	MTCR AECA EAA	Not publicly known.
June 22, 2000 report in *Far Eastern Economic Review* and July 2, 2000 report in *New York Times*	Unspecified PRC entity or entities reportedly built a second missile plant and provided specialty steel, guidance systems, and technical aid to Pakistan.	MTCR AECA EAA	On November 21, 2000, the State Department said it waived sanctions on PRC entities for past assistance to missile programs in Pakistan and Iran, while it imposed sanctions on Pakistani and Iranian entities. It is not publicly confirmed whether this action covered these transfers.
In 2000, according to a December 13, 2000 report in *Jane's Defense Weekly*	Unspecified PRC entity or entities assisted Pakistan with development of the Shaheen-2 MRBM. The DCI's reports on the year 2000 confirmed that Pakistan's development of the two-stage Shaheen-2 MRBM required "continued" PRC assistance.	MTCR AECA EAA	On November 21, 2000, the State Department said it waived sanctions on PRC entities for past assistance to missile programs in Pakistan and Iran, while it imposed sanctions on Pakistani and Iranian entities. It is not publicly confirmed whether this action covered these transfers.

A January 26, 2001 report in *Washington Times*	North China Industries Corporation (NORINCO) shipped to Iran specialty metals and chemicals used in missile production.	MTCR AECA EAA IIANA INA	May 9, 2002 sanctions under the INA and July 9, 2002 sanctions under IIANA, AECA, and EAA did not name NORINCO. Later, May 23, 2003, sanctions under E.O. 12938, June 26, 2003 sanctions under INA, September 19, 2003 sanctions under AECA and EAA, and April 1, 2004 sanctions under INA named NORINCO among entities.
In the first several months of 2001, according to an August 6, 2001 report in *Washington Times*	A PRC entity reportedly delivered 12 shipments of missile components to Pakistan for its Shaheen-1 SRBM and Shaheen-2 MRBM programs.	MTCR AECA EAA	On September 1, 2001, the State Department imposed sanctions under the AECA and EAA on China Metallurgical Equipment Corporation.
June 14, 2001 sanctions; June 28, 2001 report in *Washington Times*	Jiangsu Yongli Chemicals and Technology Import and Export Corporation transferred supplies to Iran to build a factory to manufacture dual-use equipment applicable to chemical weapons.	AG AECA EAA IIANA INA	On June 14, 2001, the State Department imposed sanctions under the INA on Jiangsu Yongli Chemicals and Technology Import and Export Corporation
Between September 2000 and October 2001, according to a July 19, 2002 report in *Washington Times*	Eight PRC entities transferred to Iran items for its chemical weapon program.	AG AECA EAA IIANA INA	On July 9, 2002, the State Department imposed sanctions under the AECA, EAA, and IIANA.

January 16, 2002 sanctions	Liyang Chemical Equipment Company, China Machinery and Electric Equipment Import and Export Company, and a PRC citizen (Chen Qingchang) transferred to Iran chemical and/or biological weapons-related items.	AG AECA EAA IIANA INA	On January 16, 2002, the State Department imposed sanctions under the INA on the three named PRC entities/persons.
February 13, 2002 report in *Jane's Defense Weekly*	PRC entity or entities transferred to Libya navigational and guidance systems.	MTCR AECA EAA	Not publicly known.
May 20, 2002 report in *Washington Times*	PRC entities transferred to Iran anti-corrosive glass-lined equipment to make chemical weapons, and NORINCO was among the entities involved. President Bush reported to Congress in June 2002 that five of the eight PRC entities were sanctioned for transferring AG-controlled items.	AG AECA EAA IIANA INA	On May 9, 2002, the State Department imposed sanctions under the INA on eight PRC entities/persons for transferring AG-controlled items and technology related to conventional weapons. NORINCO was not named.
December 9 and 17, 2002 reports in *Washington Times*	A PRC entity in Dalian, China, sold to North Korea 20 tons of tributyl phosphate (TBP), a dual-use chemical that U.S. intelligence reportedly believed would be used in nuclear weapon programs.	AECA EIBA NPPA	Not publicly known.
Reports in *Washington Post* on December 19, 2002 and February 20, 2003.	Iranian front companies procured materials from China (and other countries) for secret nuclear weapons facilities, and experts from China worked at a uranium mine at Saghand and a centrifuge facility near Isfahan. The DCI testified to Congress on February 11, 2003, and said that PRC "firms" may be backing away from the PRC's 1997 promise to forego new nuclear cooperation with Iran.	NPT IIANA INA NPPA EIBA AECA	Not publicly known.

After August 2002, according to May 22, 2003 report in *Reuters* and May 23, 2003 report in *Wall Street Journal*	NORINCO transferred missile technology to Iran for its development of medium- or longer-range ballistic missiles.	MTCR AECA EAA IIANA INA	On May 23, 2003, the State Department imposed sanctions under Executive Order 12938 on NORINCO.
June 26, 2003 sanctions	Five PRC entities, including CPMIEC and NORINCO, transferred to Iran technology for unspecified WMD or missile-related programs.	MTCR AG AECA EAA IIANA INA	On June 26, 2003, the State Department imposed sanctions under the INA on five PRC entities (and one North Korean entity).
July 30, 2003 sanctions	CPMIEC transferred missile technology to a publicly unnamed country.	MTCR AECA EAA	On July 30, 2003, the State Department imposed sanctions under Executive Order 12938 on CPMIEC.
September 19, 2003 sanctions	NORINCO transferred missile technology to a publicly unnamed country.	MTCR AECA EAA	On September 19, 2003, the State Department imposed sanctions under the AECA and EAA on NORINCO.
April 1, 2004 sanctions	Five PRC entities, including NORINCO and CPMIEC, transferred to Iran technologies related to WMD or missiles.	AECA EAA IIANA INA	On April 1, 2004, the State Department imposed sanctions under the INA.

Russia[2]

According to the CIA's "Unclassified Report to Congress on the Acquisition of Technology Relating to Weapons of Mass Destruction," Russia's "cash-strapped defense, biotechnology, chemical, aerospace, and nuclear industries continued to be eager to raise funds via exports and transfers" in the first half of 2003. In the nuclear area, Russia continues to supply assistance to Iran in the construction of the Bushehr reactor. Although this assistance violates U.S. law, technically Iran has a full-scope nuclear safeguards agreement in place, so any Nuclear Nonproliferation Treaty violation would be determined by the extent of Iran's

[2] Written by Sharon Squassoni, Specialist in National Defense.

declaring its activities to the International Atomic Energy Agency. In the missile area, Russian entities have supplied ballistic-missile-related goods and technical know-how to Iran, India, and China. Russian entities in the dual-use biotechnology and chemical fields have continued to supply equipment, materials, and technical know-how to countries of CBW concern, beyond Iran, although the CIA does not name these countries. According to the CIA, Russian assistance has "helped Iran move towards its goal of becoming self-sufficient in the production of ballistic missiles." The table below contains examples of reported Russian WMD-related transfers. It does not cover the transfers of advanced conventional weaponry, although at times the United States has imposed sanctions on Russian entities for transfers to state sponsors of terrorism.

Table 2 - Reported Cases of WMD-Related Technology Transfers by Russian Entities

Date of Reported Transfer or Report	Reported Transfer and Recipient	Possibly Applicable U.S. Law, Treaty, and/or Regime	Administration's Actions on Sanctions
1998	Missile technology, materials, and design to Iran (including training, 21 tons of maraging steel, wind tunnel technology, navigation, guidance, special alloys & coatings)	IIANA sec. 1604, 1605 FAA sec. 620G, 620H EAA sec. 11B AECA sec. 73	Sanctions imposed on July 30, 1998: BSTCU Europalace 2000 (lifted 4/1/04) Glavkosmos Grafit (lifted 4/1/04) INOR ScientificEnterprise (lifted 11/17/00) MOSO Company (lifted 4/1/04) Polyus Scientific Production Association (lifted 11/17/00) *(63 Federal Register 42089)*
1998 or before	Training of students from Iran in missile design (Bauman Moscow State Technical University), current status unknown[3]	IIANA sec. 1604, 1605 FAA sec. 620G, 620H EAA sec. 11B AECA sec. 73	Not publicly known.

[3] Center for Nonproliferation Studies, "Russia: Missile Exports to Iran," 1998.

1998	Blueprints for heavy water research reactor to Iran[4]	IIANPA sec. 1604, 1605 FAA sec. 620G, 620H	Not publicly known.
January 1999	Nuclear and missile technology to Iran	IIANPA sec. 1604, 1605 FAA, 620H AECA EAA	Sanctions imposed on January 8, 1999: D. Mendeleyev University of Chemical Technology of Russia (nuclear) Moscow Aviation Institute (missile) NIKIET (lifted 4/1/04) *(64 FR 2935)*
January to June 2001 (Sec. 721 report)	Sensitive nuclear items, technology to Iran	IIANPA sec. 1604, 1605 FAA, 620H AECA INA	Not publicly known.
January to June 2001 (Sec. 721 report)	Equipment and assistance on liquid-fueled propellant missile program to Syria	MTCR if above Category I thresholds; FAA, 620 G, 620H	Not publicly known.
1998-2003 (Sec. 721 report)	"Russian entities are a significant source of dual-use biotechnology, chemicals, production technology, and equipment for Iran."	IIANPA sec. 1604, 1605 FAA, 620H AECA INA	Not publicly known.

[4] "Fission for Cash: Money Hungry Russia Finds a Foreign Market for Nuclear Knowledge," *Wall Street Journal*, December 15, 1998.
[5] Testimony of Leonard S. Spector before the Senate Committee on Government Affairs, June 6, 2002, "Russian Exports of Sensitive Equipment and Technology."

2002[5]	Assistance for the ATV nuclear-powered ballistic missile submarine to India. Uncertain status.	MTCR	Not publicly known.
2002[6]	Assistance for the Sagarika submarine-launched missile to India. Ongoing status.	MTCR	Not publicly known.
April 2004	Transfer to Iran of equipment and technology making a material contribution to the development of WMD.	AECA EAA IIANA INA	Sanctions imposed on April 1, 2004, under the INA on Baranov Engine Building Association Overhaul Facility and Vadim V. Vorobey for 2 years. *(69 FR 18415)*

[5] Testimony of Leonard S. Spector before the Senate Committee on Government Affairs, June 6, 2002, "Russian Exports of Sensitive Equipment and Technology."

[6] Testimony of Leonard S. Spector before the Senate Committee on Government Affairs, June 6, 2002, "Russian Exports of Sensitive Equipment and Technology."

NOTES ON THE ECONOMIC DEPENDENCE OF CHINA ON THE U.S. ECONOMY

Prepared by Staff of the U.S.-China Economic & Security Review Commission
August 2004

Overview

The Chinese economy consists of a modernizing industrial sector and a traditional peasant agrarian sector. Chinese economic dependence on the U.S. economy operates primarily through the modernizing industrial sector.

This dependence rests on trade and foreign direct investment (FDI) flows.

Facts about the Chinese Economy

- According to the PRC National Bureau of Statistics, China's GDP was RMB11,669 billion in 2003. Applying an exchange rate of 8.28 RMB per dollar, this translates to $1,409 billion.

- According to the World Bank, in 2002 agriculture constituted 14.5% of the Chinese economy, industry constituted 51.7%, and services were 33.7%.

- Manufacturing was 44.5% of the economy (i.e. is the bulk of industry) in 2002. Assuming an unchanged proportion, this implies manufacturing output of $627 billion in 2003.[1]

Trade Facts

- In 2003, Chinese exports were $438.4 billion, equal to 31% of Chinese GDP.[2]

- Exports are predominantly manufactured goods, so that exports constitute roughly 69.9% of Chinese manufacturing output. This highlights the export dependence of Chinese manufacturing.

- In 2003, China had a trade surplus with the U.S. of $124 billion, equal to 8.8% of Chinese GDP and 19.8% of Chinese manufacturing output.[3] This

[1] The number for the percentage contribution of manufacturing is provided by the World Bank.
[2] Source: Hong Kong Trade and Development Council.
[3] This estimate represents an upper bound. There is a significant discrepancy between China's reported trade statistics and U.S. reported trade statistics, with China reporting larger imports from the U.S. and lower exports to the United States. The Commission believes that official Chinese statistics understate China's exports to the United States. However, it is unclear if this understatement also results in an understatement of Chinese GDP. On a rule of thumb basis, the U.S. reported numbers appear sensible. The U.S. accounts for approximately 30% of global GDP, and U.S. statistics on imports from China have the U.S. accounting for approximately one-third of total Chinese exports.

points to significant dependence of Chinese manufacturing on the U.S. market.

- Total Chinese exports to the U.S. in 2003 were $152.4 billion, which is 10.8% of GDP and 34.8% of total Chinese exports. Approximately, one third of Chinese exports go to the U.S., illustrating the importance of the U.S. market for Chinese manufacturing.

- Total Chinese imports in 2003 were $412.8 billion.[4] Chinese imports from the U.S. were $28.4 billion, representing just 6.9% of Chinese imports.

- Total U.S. goods exports to China in 2003 were $28.4 billion. Total U.S. goods exports were $713 billion.[5] Exports to China therefore represented 4% of total U.S. goods exports.

- In 2003, total U.S. goods imports from China were $152.4 billion, of which $148 billion were manufactured goods and processed chemicals. Total U.S. goods imports in 2003 were $1,260.7 billion. Goods imports from China therefore represented 12.1% of all U.S. goods imports.[6] This share is growing since U.S. imports from China are growing faster than U.S. imports from the rest of the world.

- In 2003, Foreign Invested Enterprises (FIEs) generated exports of $240.3 billion, equal to 54.8% of total Chinese exports.[7] This shows the importance of FDI for Chinese exports. These FIE exports were equal to 38.3% of total Chinese manufacturing output.

- No data is available on what proportion of FIE output is exported and what proportion is retained for Chinese domestic consumption. If we assume 100% of FIE output is exported, then FIEs account for 9.6% of total Chinese manufacturing value-added. If we assume 75% of FIE output is exported, then the FIE share of total manufacturing value-added rises to 12%. This illustrates the importance of FDI for Chinese manufacturing.

- ***In sum, (1) China is heavily dependent on the U.S. market for its exports. (2) Only a small share of Chinese imports come from the U.S. (3) Exports to China are a small share of U.S. exports. (4) Imports from China represent a significant share of U.S. imports. (5) Foreign invested enterprises make a very large contribution to Chinese exports and China's balance of trade surplus.***

Foreign Direct Investment (FDI) Facts

[4] Source: Foreign Trade Statistics, U.S. Census Bureau.
[5] Source: Foreign Trade Statistics, U.S. Census Bureau.
[6] Source: Foreign Trade Statistics, U.S. Census Bureau.
[7] Source: Hong Kong Trade and Development Council.

- Total FDI in China in 2003 was $53.5 billion, and China now has accumulated FDI of $502 billion.[8] China is the leading destination for FDI in the developing world, and is on track to become the second largest holder of FDI in the world.

- In 2003, official U.S. FDI in China was $4.2 billion, which was 7.9% of all FDI in China.[9]

- However, there are grounds for believing that the U.S. contribution may be larger than officially recorded since the Virgin Islands invested $5.8 billion in China; the Cayman Islands invested $0.9 billion; and Western Samoa invested $1.0 billion. These investments may well represent off-shored American capital.[10]

- Total accumulated U.S. FDI in China stands at $48.8 billion.[11] This is 9.7% of total accumulated world FDI in China.

- The significance of U.S. FDI is that it is a vehicle for transferring manufacturing technology to China. Additionally, FDI can be a vehicle for transferring research and development capability, as illustrated by Delphi Corporation's recent decision to invest $50 million in China.[12]

- FDI in China must be considered jointly with trade, since the ability to export from China encourages firms to undertake FDI in China. From this perspective, the U.S. matters very much for FDI in China. Not only is the U.S. a direct provider of FDI to China, the ability of China to export into the U.S. market acts as a magnet for FDI in China from other countries.

[8] Commission calculation using U.S.-China Business Council data.
[9] Source: The U.S.-China Business Council.
[10] Source: The U.S.-China Business Council.
[11] Source: The U.S.-China Business Council.
[12] Source: Automotive News, May 3, 2004.

QUESTIONS AND ANSWERS SUBMITTED FOR THE RECORD

JUNE 16, 2004

QUESTIONS SUBMITTED BY MR. SKELTON

Mr. SKELTON. I see this as an American problem, that we do not have a real cultural awareness of people with who we are dealing, people who might well at some time be a potential adversary. And I would appreciate if, in your next round of recommendations, you would address the lack of our cultural understanding.

Mr. ROBINSON. The Commission will follow up on the suggestion that we look for ways to enhance the U.S. government's and the American people's knowledge of Chinese language, culture, and society. We agree that this is vital to the sound development of U.S. policies toward China.

In our 2002 Report to Congress, the Commission found that "The U.S. Government has dedicated insufficient resources to collect, translate, and analyze Chinese writings and statements" and consequently "has a limited understanding of the perceptions of the United States held by Chinese leaders and the Chinese people." To help address this concern, the Commission made the following recommendations in its 2002 Report:

a. "The Library of Congress China collection today is nearly unusable and is a disgrace, despite two major studies advocating a more robust and sophisticated collection. The Commission recommends, therefore, on an urgent basis that the Congress fund the appropriate implementation of the detailed recommendations already submitted by these two previous investigations."

b. "The Commission recommends that Congress expand the U.S. Government capacities for collection, translation and analysis of open source Chinese language materials, including expanding the scope of Chinese materials translated by the Foreign Broadcast Information Service (FBIS) and enhancing the Library of Congress' collection. The Central Intelligence Agency, the Defense Intelligence Agency, and other appropriate Executive Branch agencies should report annually to the Congress on their resources and progress in this area."

c. **"The Commission recommends that Congress provide federal funding and other incentives to strengthen Chinese language and area studies programs in U.S. universities, similar to the program that was developed with regard to the Soviet Union and Eastern Europe in the National Defense Education Act of 1958. In conjunction, there should also be incentives given to post-secondary graduates in this field to provide government service."**

Incentives to maintain a greater knowledge and understanding of Chinese language, culture, and society in the United States are an issue of great concern to the Commission and we plan to examine them further in the coming year.

Thank you again for the opportunity to appear before the Committee. Please let us know if we can provide any additional information on these questions or any other topics in U.S.-China relations.

QUESTIONS AND ANSWERS SUBMITTED BY MR. TAYLOR

Mr. TAYLOR. What were the Chinese public's perceptions of the EP–3 incident in April 2001?

Mr. ROBINSON. In 2002, the Commission commissioned a study by the University of Maryland to track Chinese perceptions of the United States in selected Chinese newspapers. The study focused on the months surrounding the EP–3 Reconnaissance Plane Incident in April 2001, the September 11 terrorist attacks, and the President Bush's visit to China in February 2002. It also examined the three-month period between February 2002 and April 2002, a relatively quiet period of time with few major Sino-U.S. action, as a control.

The report concluded that, in the days prior to the EP–3 incident, news reports concerning the United States were generally neutral or positive in tone. Following the incident, the tone became more negative. Moreover, local newspaper reports

were significantly more negative in tone toward the United States than the national or large city newspapers on the day the incident was initially reported and the day the flight crew was released.

By comparison, the two weeks before and after 9/11 found reporting on the United States to be neutral, with some negativity, again, in local newspapers. The two weeks before and after President Bush's visit to China was characterized by a more positive tone in reporting.

The University of Maryland study focused on the general tone of newspaper reporting on the United States, rather than detail of specific content. However, anecdotal evidence from news at the time of the EP–3 Incident reveals that much of the outware emotion over the incident was directed toward grief over the death of Wang Wei, the Chinese pilot who died during the crash. President Jiang Zemin gave him the posthumous title of "Guardian of the Air and Sea." The Internet played a major role in this outpouring of grief through several memorial site chat rooms. A small sampling of these chat rooms reveals that in April 2001 most of the focus was on expressions of grief for Wang Wei or proclamations of Chinese strength, although some did include derogatory remarks aimed at the United States. Chinese hackers also executed a cyber attack on the United States following the incident, successfully hacking into government networks and posting messages such as "Beat Down American Imperialists."

QUESTIONS AND ANSWERS SUBMITTED BY MR. HOSTETTLER

Mr. HOSTETTLER. With regard to the impact of U.S. interaction with the Chinese economy on an annual basis, do we have an idea of how much that affects the entire economy of China?

Mr. ROBINSON and Ms. BARTHOLOMEW. Thank you again for the opportunity to testify before the Armed Services Committee on behalf of the U.S.-China Economic and Security Review Commission. At the hearing on June 16, we promised to provide Congressman Hostettler with a response to his question about China's economic dependence on the U.S. economy.

The main features of China's economic dependence on the U.S. are described below, and the accompanying attachment provides further details. A problem in making inferences about this dependence is that there is a significant discrepancy between China's reported trade with the U.S. and U.S. reported trade with China. The Commission believes that U.S. statistics are more accurate, and U.S. trade data have been used in arriving at the following findings.

- The Chinese economy consists of a modernizing industrial sector and a traditional peasant agrarian sector, and Chinese economic dependence on the U.S. economy operates primarily through the modernizing industrial sector.
- Chinese economic dependence on the U.S. rests both on trade and foreign direct investment (FDI).
- Exports provide an outlet for Chinese production of manufactured goods, and exports are a major source of foreign exchange for China. Total Chinese exports are valued at 31% of Chinese GDP, indicating the export dependence of Chinese manufacturing.
- In 2003, China had a trade surplus with the U.S. of $124 billion, which is equal to 8.8% of Chinese GDP and 19.8% of Chinese manufacturing output. This is indicative of significant dependence of Chinese manufacturing on the U.S. market.
- China is heavily dependent on the U.S. market for its exports (34.8%), but only a relatively small share of Chinese imports (6.9%) come from the United States. Exports to China are a small share of U.S. exports (4%), but imports from China are over ten percent of U.S. imports (12.1%).
- Foreign invested enterprises make a very large contribution to Chinese exports and China's balance of trade surplus. They accounted for 54.8% of China's exports in 2003.
- FDI flows finance foreign company acquisition and building of plants in China. These foreign-owned plants are a vehicle for transferring manufacturing technology and research and development capability to China. They are also significant export generators. Since these investments are financed by foreign owners, China acquires productive capacity and export earning capacity without having to borrow on world financial markets. Indeed, China actually acquires foreign exchange with FDI since investors convert foreign currency into Chinese currency to pay the bills associated with acquisition and building of plant.

- Trade and FDI must be considered jointly since the ability to export from China encourages firms to undertake FDI in China. From this perspective, the U.S. matters very much for FDI in China. The U.S. is a direct provider of FDI to China, and in addition the ability of China to export into the U.S. market acts as a magnet for FDI in China from other countries.

China is acquiring modern production capacity through FDI, and it is also acquiring significant financial claims against the U.S. through its trade surplus with the United States. Balanced against this, U.S. companies are acquiring production capability in China, and U.S. consumers are getting cheap consumer goods.

The current relationship is unhealthy and carries significant downside risk. On the economic side, the U.S. is losing manufacturing jobs and capacity, and is becoming increasingly dependent on Chinese sources of supply. Professional economists agree that the trade deficit is unsustainable at its current level, though none can predict when a breaking point will be reached. The danger is that when this happens, U.S. domestic manufacturing capacity will have become so undermined that adjustment will involve significant prolonged economic dislocation and a large fall in the standard of living.

On the national security side, the transfer of manufacturing and technological expertise is strengthening China's military capability, posing an increasing risk to U.S. national interests in the Pacific basin. It is also establishing China as a global super-power, capable of challenging U.S. interests in other regions of the world.

At the moment, the Chinese economy is significantly more dependent on the U.S. economy. However, this balance is shifting. China's acquisition of production capacity, technology, and R&D capability is strengthening China's economic fundamentals and giving it industrial independence, while its acquisition of financial claims against the U.S. is giving it financial strength and independence. These developments are of serious concern.

Thank you for the opportunity to respond to this insightful question. Please let us know if we can provide any additional information.

QUESTIONS AND ANSWERS SUBMITTED BY MR. LANGEVIN

Mr. LANGEVIN. What percentage of U.S. debt is currently held by China?

Mr. ROBINSON. According to U.S. Treasury Department numbers, as of April 2004, China held $164.1 billion in treasury securities (over 4% of the privately held U.S. debt). If Hong Kong is included in that number, the total comes to $212.1 billion (about 5%). This figure refers exclusively to holdings of U.S. Treasury obligations. It does not include Chinese holdings of non-government dollar denominated financial assets such as agency debt (e.g. Fannie Mae obligations) and deposits with money center banks. Comprehensive data on Chinese foreign reserve holdings by currency and asset type do not appear to be publicly available. This issue is one the Commission will continue to monitor.

QUESTIONS AND ANSWERS SUBMITTED BY MR. LARSEN

Mr. LARSON. Have there been any developments with the Proliferation Security Initiative (PSI) with respect to China since the writing of the Commission's Report?

Mr. ROBINSON. In June 2004, the PSI celebrated its first anniversary as a global network cooperating to prevent WMD proliferation. Since the writing of the Commission's report, Canada, Denmark, Norway, Singapore, Turkey, Panama and Russia have agreed to participate in the PSI, joining the United States, Japan, Australia, Italy, France, Germany, Poland, Portugal, the Netherlands, Spain, and Liberia. In the same spirit, the UN Security Council unanimously approved Council Resolution 1450, which requires states to develop domestic laws to curb WMD proliferation.

To date, China has not yet agreed to join the PSI. The Chinese government on February 12, 2004, via foreign ministry spokeswoman Zhang Qiyue has commented that, "We believe that the issue of proliferation shall be resolved through political and diplomatic means within the framework of international laws, and all non-proliferation measures shall contribute to peace, security, and stability in the region and the world at large." Moreover, Zhang expressed concern about "the legal foundation and consequences therefrom (sic) of the PSI interception." The Commission stated in its 2004 Report, "China appears to be working through the United Nations to not only undermine the initiative but also to render it globally ineffective." The Commission is concerned that China could continue to work to undermine the PSI.

The Commission will be carefully monitoring this issue as part of our ongoing work in this area.

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